

ERSTE BANK HUNGARY Zrt.

Consolidated Financial Statements in accordance with
International Financial Reporting Standards as adopted by the
European Union for the year ended 31 December 2016
with the Independent Auditors' Report

Independent Auditors' Report

To the Shareholders of ERSTE BANK HUNGARY Zrt.

Opinion

We have audited the accompanying 2016 consolidated financial statements of ERSTE BANK HUNGARY Zrt. and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2016 - showing a total assets of HUF 2,046,881 million and a total comprehensive income of HUF 42,773 million -, the related consolidated income statement and consolidated statement of comprehensive income, consolidated statement of changes in total equity, consolidated statement of cash flows for the year then ended and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016 and of its consolidated financial performance and its consolidated cash flows for the financial year then ended in accordance with International Financial Reporting Standards as adopted by the EU ("EU IFRSs").

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing and Hungarian National Auditing Standards and with applicable laws and regulations in Hungary. Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the consolidated financial statements" section of our report.

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in Hungary, and we have fulfilled our ethical responsibilities in accordance with these requirements.

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

Key audit matters

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

We have fulfilled the responsibilities described in the “Auditor’s responsibilities for the audit of the consolidated financial statements section” of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Credit Impairment

Credit impairment is a highly subjective area due to the level of judgement applied by management in determining loan loss provisions. The identification of impairment and the determination of the recoverable amount are an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, and expected net selling prices of collaterals. The portfolios which give rise to the greatest uncertainty are typically those where impairments are derived from estimates of future cash flows and realizable value of collateral, calculated using collective impairment models, are unsecured or are subject to potential collateral shortfalls. The use of different modelling techniques and assumptions could produce significantly different estimates of loan loss provisions.

Due to the significance of Loans and receivables to customers (representing 49.9% of Total assets) and the related estimation uncertainty, this is considered a key audit matter.

We involved our internal valuation specialists to assist us in performing our audit procedures. Our audit procedures included among others the following procedures.

We assessed the design and tested the operating effectiveness of internal controls over the approval, recording and monitoring of loans and advances and controls over impairment calculations including the quality of underlying data and systems.

For allowances for loans and receivables to customers calculated on an individual basis (specific provision), we tested the assumptions underlying the impairment identification and quantification focusing on loan cases with the most significant potential impact on the consolidated financial statements. We assessed the Group’s assumptions on the expected future cash flows, including the value of realisable collateral and estimates of recovery on default based on our own understanding and available market information. For allowances for loans and receivables to customers

calculated on a collective basis (portfolio provision) we evaluated the methodologies, inputs and assumptions used, including model validations and backtesting.

We also assessed whether the consolidated financial statement disclosures appropriately reflect the Group's exposure to credit risk and are compliant with EU IFRSs.

The Group's disclosures about its risk management policies are included in Note 35 which specifically explains the key assumptions used when determining credit risk and their evaluation are detailed in Note 18.

Large debt sale of retail loan portfolio

The Group sold HUF 31.6 billion (gross value) of retail non-performing loans during 2016. The Group created a significant amount of provisions for contingent obligation resulting from the large debt sale of its non-performing loan portfolio.

The derecognition of the portfolio required assessing the transfer of the risk and rewards connected to this subportfolio based on the terms of the signed contract. The assessment of the potential contingent liability arising from the sale contract and its magnitude also required high level of judgement as there is an inherent risk that the provisions created at the year-end may significantly differ from the actual expenditure realized in the upcoming years.

Due to the size of the transaction and to the difficulty in assessing and measuring the quantum from any resulting obligations, large debt sale of retail loan portfolio is considered a key audit matter.

Among other audit procedures, we inspected the sales contract to identify how much residual risk remained at the Group.

We tested derecognition of this loan portfolio and assessed the adequacy of the Group's disclosures regarding the matter.

We assessed the adequacy of the underlying data collected by the Group for supporting the provision calculated for the potential contingent liabilities arising from the contractual obligations.

We also assessed whether the consolidated financial statements include appropriate disclosures related to large debt sale of retail loan portfolio. The Group's disclosure is included in Note 25.

Information Technology (IT) systems

A significant part of the Group's financial reporting process is heavily reliant on IT systems with automated processes and controls over the capture, storage and extraction of information. A fundamental component of these processes and controls is ensuring appropriate user access and change management protocols exist, and are being adhered to.

These protocols are important because they ensure that access and changes to IT systems and related data are made and authorised in an appropriate manner.

As our audit sought to place a high level of reliance on IT systems and application controls related to financial reporting, a high proportion of the overall audit effort was in this area. Furthermore the complexity of IT systems and nature of application controls requires special expertise to be involved in the audit. We therefore consider this as a key audit matter.

We focused our audit on those IT systems and controls that are significant for the Group's financial reporting. As audit procedures over the IT systems and application controls require specific expertise, we involved our IT audit specialists in our audit procedures.

We understood and assessed the overall IT control environment and the controls in place which included controls over access to systems and data, as well as system changes. We tailored our audit approach based on the financial significance of the system and whether there were automated procedures supported by that system.

As part of our audit procedures we tested the operating effectiveness of controls over appropriate access rights and validating that only appropriate users had the ability to create, modify or delete user accounts for the relevant in-scope applications. We also tested the operating effectiveness of controls around system development and program changes to establish that changes to the system were appropriately authorised and also developed and implemented properly. Additionally, we assessed and tested the design and operating effectiveness of the application controls embedded in the processes relevant to our audit.

Other information

Other information consists of the 2016 consolidated business report of the Group. Management is responsible for the preparation of the consolidated business report in accordance with the Act C of 2000 on Accounting (“Hungarian Accounting Law”) and other relevant legal requirements, if any. Our opinion on the consolidated financial statements 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 1) 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 and 2) the consolidated business report has been prepared in accordance with the Hungarian Accounting Law and other relevant legal requirements, if any.

Our opinion on the consolidated business report should include the information required according to Subsection (2) e) of Section 95/B of the Hungarian Accounting Law and we are required to confirm also whether the information prescribed in Subsection (2) a)-d) and g) of Section 95/B of the Hungarian Accounting Law have been made available.

In our opinion, the consolidated business report of the Group, including the information required according to Subsection (2) e) of Section 95/B of the Hungarian Accounting Law for 2016 corresponds to the 2016 consolidated financial statements of the Group and has been prepared in accordance with the Hungarian Accounting Law.

Since no other legal regulations prescribe for the Group further requirements with regard to its consolidated business report, our opinion on the consolidated business report does not include opinion in this regard as required by Subsection (5) h) of Section 156 of the Hungarian Accounting Law.

We also confirm that the Group have made available the information required according to Subsection (2) a)-d) and g) of Section 95/B of the Hungarian Accounting Law.

Further to the above, based on the knowledge we have obtained about the Group and its environment in the course of the audit we are required to report whether we have identified any material misstatement in the consolidated business report, and if so, the nature of the misstatement in question. 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 the EU IFRSs, 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.

Auditor's 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 auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing and Hungarian National Auditing Standards 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 International Standards on Auditing and Hungarian National Auditing Standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

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

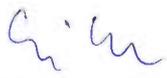
- ▶ Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we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

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in 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 to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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

Budapest, 7 April 2017



Szabó Gergely
engagement partner
Ernst & Young Kft.
1132 Budapest, Váci út 20.
Registration No.: 001165



Szabó Gergely
Registered auditor
Chamber membership No.: 005676

Erste Bank Hungary Zrt.

CONSOLIDATED FINANCIAL STATEMENTS
IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING
STANDARDS AS ADOPTED BY THE EUROPEAN UNION
FOR THE YEAR ENDED
31 DECEMBER 2016

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Consolidated Financial Statements 2016 (IFRS)

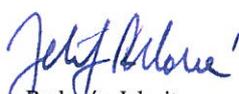
I. Consolidated Income Statement for the year ended 31 December 2016

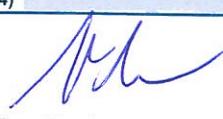
in HUF million	Notes	2015 reclassified	2016
Net interest income	1	62,003	56,796
Net fee and commission income	2	42,591	44,161
Dividend income	3	55	28
Net trading and fair value result	4	(185)	6,738
Rental income from investment properties & other operating leases	5	273	1,236
Personnel expenses	6	(26,226)	(28,501)
Other administrative expenses	6	(23,108)	(26,064)
Depreciation and amortisation	6	(6,401)	(6,340)
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net		(1,456)	2,890
Net impairment loss on financial assets not measured at fair value through profit or loss	8	(41,807)	(5,297)
Other operating expenses	9	(28,466)	(19,893)
Other operating result	9	2,827	21,117
FX settlement effect	9	1,330	548
Pre-tax result from continuing operations		(18,571)	47,420
Taxes on income	10	(3,440)	(4,077)
Net result for the period		(22,010)	43,343
Net result attributable to non-controlling interests		-	-
Net result attributable to owners of the parent		(22,010)	43,343

II. Consolidated Statement of Comprehensive Income for the year ended 31 December 2016

in HUF million	2015 reclassified	2016
Net result for the year	(22,010)	43,343
Items that may be reclassified to profit or loss		
Available for sale reserve (including currency translation)	4,691	(1,928)
Gain/loss during the year	4,688	(1,928)
Reclassification adjustments	2	-
Cash flow hedge reserve (including currency translation)	1,339	740
Gain/loss during the year	-	-
Reclassification adjustments	1,339	740
Deferred taxes relating to items that may be reclassified	(874)	618
Gain/loss during the year	(874)	618
Reclassification adjustments	-	-
Total other comprehensive income	5,156	(570)
Total comprehensive income	(16,854)	42,773
Total comprehensive income attributable to non-controlling interests	-	-
Total comprehensive income attributable to owners of the parent	(16,854)	42,773

Date: Budapest, 7 April 2017


Radován Jelasity
Chairman and CEO


Ivan Vondra
Chief Financial Officer

III. Consolidated Statement of Financial Position at 31 December 2016

in HUF million	Notes	2015 reclassified	2016
Assets			
Cash and cash balances with central bank	11	111,869	106,050
Financial assets - held for trading		69,194	133,055
Derivatives	12	11,161	15,397
Other trading assets	13	58,034	117,658
Financial assets - available for sale	14	89,555	137,749
Financial assets - held to maturity	15	294,731	436,668
Loans and receivables to credit institutions	17	278,436	145,499
Loans and receivables to customers	18	1,006,602	1,021,232
Property and equipment	19	8,590	8,991
Investment properties	19	10,926	10,620
Intangible assets	19	13,041	18,310
Current tax assets	20	892	1,000
Deferred tax assets	20	122	33
Assets held for sale	21	26	187
Other assets	22	40,496	27,486
Total assets		1,924,481	2,046,881
Liabilities and equity			
Financial liabilities - held for trading		20,630	12,398
Derivatives	12	20,566	11,337
Other trading liabilities	23	64	1,060
Financial liabilities designated at fair value through profit or loss		-	24,481
Debt securities issued	24	-	24,481
Financial liabilities measured at amortised cost		1,712,781	1,671,155
Deposits from banks	24	426,805	213,655
Deposits from customers	24	1,262,093	1,419,097
Debt securities issued	24	23,883	38,403
Provisions	25	9,846	25,156
Current tax liabilities	20	13	9
Deferred tax liabilities	20	874	238
Other liabilities	26	20,069	32,429
Total equity	27	160,268	281,015
Equity attributable to non-controlling interests		-	-
Equity attributable to owners of the parent		160,268	281,015
Total liabilities and equity		1,924,481	2,046,881

Date: Budapest, 7 April 2017


Rađovan Jelasić
Chairman and CEO


Ivan Vondra
Chief Financial Officer

IV. Consolidated Statement of Changes in Total Equity

Statement of changes in total equity for the year ended 31 December 2016

in HUF million	Notes	Subscribed capital	Additional paid-in capital	Retained earnings	Available for sale reserve ²⁾	Cash flow hedge reserve ²⁾	Deferred tax related to 'Available for sale reserve' ²⁾	Deferred tax related to 'Cash flow hedge reserve' ²⁾	Attributable to owners of the parent	Attributable to non-controlling interests	Total equity 2016
Total equity at 01 January 2016	27)	102,000	83,493	(28,162)	4,772	(961)	(874)	-	160,268	-	160,268
Dividends		-	-	-	-	-	-	-	-	-	-
Capital increases ¹⁾		44,000	33,974	-	-	-	-	-	77,974	-	77,974
Transfer		-	25	(25)	-	-	-	-	-	-	-
Total comprehensive income		-	-	43,343	(1,928)	740	618	-	42,773	-	42,773
of which: Net profit / (loss) for the year		-	-	43,343	-	-	-	-	43,343	-	43,343
of which: Other comprehensive income ²⁾		-	-	-	(1,928)	740	618	-	-	-	(570)
Total equity at 31 December 2016	27)	146,000	117,492	15,156	2,844	(221)	(256)	-	281,015	-	281,015

1) Details see in Note 27) Total equity, section Subscribed capital and additional paid-in capital, page 47.

2) All items are to reclassify subsequently into profit and loss, in both year.

Statement of changes in total equity for the year ended 31 December 2015

in HUF million	Notes	Subscribed capital	Additional paid-in capital	Retained earnings	Available for sale reserve	Cash flow hedge reserve	Deferred tax related to 'Available for sale reserve'	Deferred tax related to 'Cash flow hedge reserve'	Attributable to owners of the parent	Attributable to non-controlling interests	Total equity 2015
Total equity at 01 January 2015	27)	102,000	283,327	(205,986)	81	(2,300)	-	-	177,122	-	177,122
Dividends		-	-	-	-	-	-	-	-	-	-
Capital increases		-	-	-	-	-	-	-	-	-	-
Transfer		-	(199,834)	199,834	-	-	-	-	-	-	-
Total comprehensive income		-	-	(22,010)	4,691	1,339	(874)	-	(16,854)	-	(16,854)
of which: Net profit / (loss) for the year		-	-	(22,010)	-	-	-	-	(22,010)	-	(22,010)
of which: Other comprehensive income		-	-	-	4,691	1,339	(874)	-	5,156	-	5,156
Total equity at 31 December 2015	27)	102,000	83,493	(28,162)	4,772	(961)	(874)	-	160,268	-	160,268

V. Consolidated Statement of Cash Flows

in HUF million	2015	2016
Net result for the period	(22,010)	43,343
Non-cash adjustments for items in net profit/loss for the year		
Depreciation, amortisation, impairment and reversal of impairment, revaluation of assets	7,151	7,935
Allocation to and release of provisions (including risk provisions) and provision for FX settlement	(9,137)	(143,078)
Gains/(losses) from the sale of assets	2,194	3,677
Revaluation of subordinated liabilities	(727)	214
FX settlement effect - exposure decrease for existing loans	(2,693)	-
Revaluation of derivatives	10,128	(13,578)
Other adjustments	2,102	193
Changes in assets and liabilities from operating activities after adjustment for non-cash components		
Financial assets - held for trading	(39,644)	(59,714)
Financial assets - available for sale	3,382	(1,509)
Financial assets - held to maturity	(340)	888
Loans and receivables to credit institutions	32,321	132,937
Loans and receivables to customers	133,531	142,442
Derivatives - hedge accounting	-	-
Other assets from operating activities	2,310	8,844
Financial liabilities - held for trading	(2,313)	1,200
Financial liabilities designated at fair value through profit or loss	-	24,481
Financial liabilities measured at amortised cost	68,582	35,845
Deposits from banks	46,797	(135,679)
Deposits from customers	22,631	157,004
Debt securities issued	(847)	14,520
Derivatives - hedge accounting	-	-
Other liabilities from operating activities	1,259	12,356
Cash flow from operating activities	186,094	196,476
Proceeds of disposal		
Financial assets - held to maturity	40,181	105,944
Financial assets - available for sale	19,613	58,544
Property and equipment, intangible assets and investment properties	1,270	86
Acquisition of		
Financial assets - held to maturity	(110,725)	(248,769)
Financial assets - available for sale	(88,025)	(106,539)
Property and equipment, intangible assets and investment properties	(7,135)	(11,850)
Cash flow from investing activities	(144,821)	(202,584)
Capital increases	-	77,974
Subordinated loan repayment	-	(77,685)
Subordinated loan received	-	-
Cash flow from financing activities	-	289
Cash and cash equivalents at beginning of period	70,596	111,869
Cash flow from operating activities	186,094	196,476
Cash flow from investing activities	(144,821)	(202,584)
Cash flow from financing activities	-	289
Effect of currency translation	-	-
Cash and cash equivalents at end of period	111,869	106,050
Cash flows related to taxes, interest and dividends		
Payments for taxes on income (included in cash flow from operating activities)	3,323	3,746
Interest received	92,718	74,322
Dividends received	55	28
Interest paid	(36,521)	(12,704)

VI. Notes to the Consolidated Financial Statements

A. GENERAL INFORMATION

Erste Bank Hungary Zrt. (referred to as 'Bank') is a member of Erste Group, the largest privately owned Austrian banking group, listed on the Vienna, Prague and Bucharest Stock Exchanges (Erste Group Bank AG). The Bank with its fully owned subsidiaries forms Erste Hungary. The Bank is a limited liability company, incorporated and domiciled in Hungary. The registered office of the Bank is 24-26. Népfürdő utca, 1138 Budapest, Hungary.

As of 31 December 2016, the direct parent of the Bank – owning 70% of the shares – was Erste Group Bank AG, whose registered office at that date was Am Belvedere 1, 1100 Vienna, Austria. The Consolidated Financial Statements of Erste Group are prepared by the ultimate parent of Erste Group 'Erste Group Bank AG', and are available after their completion at the Court of Registry of Vienna, Marxergasse 1a, 1030 Vienna, Austria.

Hungarian State and EBRD acquired minority stakes in Erste Bank Hungary Zrt.

In June 2016 Corvinus Nemzetközi Befektetési Zrt. (representing the Hungarian State) and the European Bank for Reconstruction and Development (EBRD) signed the contractual framework with Erste Group Bank AG to acquire minority equity stakes of 15 per cent each in Erste Bank Hungary Zrt. The purchase price was 77.78 billion forint. After the regulatory approvals regarding the transaction and completion of other conditions of the contracts, the transfer of ownership occurred in August 2016.

The share purchase was approved by the National Bank of Hungary (NBH) on August 4, 2016 (H-EN-I-693/2016), and the change in the ownership was registered in the company register on August 24, 2016

The new ownership structure of Erste Bank Hungary Zrt. is the following:

Owner	Number of shares	Ownership share
Erste Group Bank AG	102,200,000,000	70%
Corvinus Nemzetközi Befektetési Zrt.	21,900,000,000	15%
European Bank for Reconstruction and Development	21,900,000,000	15%
Total	146,000,000,000	100%

As part of the agreement, both EBRD and Corvinus Zrt. delegated one member to the Supervisory Board and one non-executive member to the Board of Directors of Erste Bank Hungary. Furthermore, in line with the Memorandum of Understanding, the Hungarian Government further reduced Hungary's banking tax in 2017.

Subsidiaries

The subsidiaries of the Bank, all registered in Hungary, as of 31 December 2016 are as follows:

Interest of Erste Bank Hungary in % - directly or indirectly			
Company name	2015	2016	Core activity
Erste Befektetési Zrt.	100%	100%	brokerage services
Erste Leasing Bérlet Szolgáltató Kft.	100%	0%	no activity, under winding up procedure (terminated in January, 2016)
Erste Lakáslízing Zrt.	100%	100%	financial leasing of properties
Erste Ingatlan Kft.	100%	100%	property management
Sió Ingatlan Invest Kft.	100%	100%	property development
Erste Lakástakarék Zrt.	100%	100%	building society
Erste IN-FORG Kft.	100%	100%	property management
Collat-Reál Kft.	100%	100%	property management
Erste Jelzálogbank Zrt.	100%	100%	refinancing activity

Erste Hungary's activity

The Bank with its subsidiaries offers a complete range of banking and other financial services to customers, such as savings accounts, asset management, consumer credit and mortgage lending, building society services, investment banking, securities and derivatives trading, portfolio management, project finance, foreign trade financing, corporate finance, capital market and money market services, foreign exchange trading, leasing and factoring. Erste Hungary concentrates its activity in the Hungarian market.

B. ACQUISITIONS, MERGERS AND DISPOSALS

ERSTE Jelzálogbank Zrt.

In 2015 the Bank established its new mortgage bank, Erste Jelzálogbank Zrt and as an important milestone in the first half of 2016 the mortgage bank was granted all licenses necessary to its operation as a credit institution. In 2016 two bond issuance programs already occurred in the amount of 46.4 billion forint. Together with the mortgage bank, Erste Bank Hungary has the potential to increase the percentage of its long-term liabilities and provide other banks with refinance, utilising business potential

Budapest Stock Exchange

The Bank has acquired a minority shareholding of 2.3% in the Budapest Stock Exchange (BSE) from ING Bank. CEO of Erste Befektési Zrt. was appointed as a member of the Board of Directors of BSE.

Collat-Reál Kft.

Erste Bank Hungary Zrt. sold its shares incorporating 100% ownership in Collat-Reál Kft. to its solely owned subsidiary, the Erste Ingatlan Kft on November 30, 2016.

C. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS

(i) Home rescue plan of 2011

In June 2011 the Hungarian Parliament approved the "Home rescue plan" applicable to financial institutions. The main objective of the plan was to provide a benefit for citizens having mortgage loans or residential real estate finance lease contracts denominated in Swiss Franc, Euro or Japanese Yen, as their monthly instalments were significantly impacted by changes in foreign exchange rates. Erste Hungary recognised significant losses due to the government legislation. The plan relied on different schemes such as

- End payment that meant that eligible customers were allowed to repay in one lump sum their mortgage loans denominated in defined foreign currencies (end payment) at fixed foreign exchange rates far below market rates.
- Measures related to customers of more than 90 days past due which meant for clients electing to participate in this scheme that Erste Hungary was obliged to write off 25% of the total outstanding exposure and convert the foreign currency loan into a forint denominated loan.
- Measures related to customers of less than 90 days past due or current which meant that eligible customers applied to fix their monthly instalments at a fixed foreign exchange rate for the next five years. Differences coming from the different rates were accumulated in a buffer account bearing BUBOR-only interest related to capital element and are reimbursed by the state related to interest element. After the legally obliged conversion of FX loans in 2015, the levy was terminated.

(ii) Legislative measures in 2014 having the same general goals as 'Home rescue plan' of 2011 did

Legal measures by Government (Curia laws)

Supreme Court uniformity decision of 2/2014. PJE

Supreme Court of Hungary (Curia) published a uniformity decision in three topics related to foreign currency denominated loans at 16 June 2014.

(1) Bid/ask spread related to foreign currency (FX) denominated loans

The practice of financial institutions applying bid FX rate at disbursement and ask FX rate at instalment is an unfair practice as there is no underlying service. The fair procedure is to apply the average rate of the National Bank of Hungary (NBH).

(2) Unilateral contract modification

Any unilateral contract modification applied by the financial institution is presumed as unfair. The unilateral modification is defensible only if

- The reason for modification is compliant with the comprehensive list of eventual qualifying reasons published in the general terms and conditions.
- It is clearly defined and comprehensible for the client that the qualifying reasons how and in what extent influence their payment obligations.
- It is transparent that the unilateral modification is based on the principles of symmetry, proportionality and factuality in relation to the underlying reason.

(3) Foreign currency rate risk

Foreign currency rate risk charged completely on the client in return of more favourable interest rates is not stated as unfair practice.

The principles and its consequences stated in this uniformity decision are incorporated in different legal acts like:

- *Curia law*
- *Settlement law*
- *Conversion law*
- *Three decrees by NBH on settlement and client information,*

having as consequences that contractual conditions legally applied in the past are stated unfair by the law, retroactively.

The *Fair banking law* is a more general legal act, not in direct relation with government measures aiming to better and settle the situation of citizen facing significantly increased instalment due to foreign currency fluctuations, but to define general principles and pillars for the whole banking sector by setting new standards mainly focusing client information and interest charges.

These legal acts are detailed below in chronological order of their pass.

Curia law of 2014:XXXVIII (passed July 2014)

The law compels financial institutions to reimburse their clients for imposing unfair unilaterally modified interest, fee, charges and for charging bid/ask spread margin. The presumption of unilateral contract modification related to the above conditions is stated to be unfair. All types of consumer loans and leasing agreement are in scope, both active and closed, foreign currency and forint denominated. Further criterion is that the contract was concluded after 30 April 2004 and was not terminated or fully settled at least 5 years before entering into force of this act (14 July 2014). Overdrafts and credit cards are out of the scope.

Settlement law of 2014:XL (passed September 2014)

In scope are basically the deals under Curia law with the modification that settlement obligation has to be applied to all active contracts including overdraft, credit cards, end payments and loans under National Asset Management Agency (“NAMA”) program but not to be applied to subsidized forint loans.

Presumption of unfairness of unilateral contract modification is restated for loans concluded after 27 November 2010 (regulation changed regarding contract modification introducing stricter rules), so they were presumed to be fair.

Otherwise the Act states the following rules to be applied relating to settlement obligation:

Calculation methods

Detailed formulas and calculation methods were published via three NBH decrees (see in last point of this section). The basic rules are the followings:

- In order to calculate the reimbursement obligation amount annuity recalculation is needed at each instalment date, starting by original disbursement and related origination fees. Recalculated differences at each instalment date have to be considered as prepayments of the loans.
 - From calculated compensation amount any benefit provided earlier by the Bank to the clients is to deduct i.e. principal partial write-off, or interest benefit.
- Client of closed deals has to be settled in cash.

Client information

Clients affected by foreign currency denominated loans measures are to inform between 1 March 2015 and 30 April 2015. Client affected by forint denominated loans measures are to inform between 15 August 2015 and 30 September 2015.

Termination moratorium

There is a moratorium for contract terminations initiated by the Bank until the delivery of settlement documentation to the clients, but no later than 31 December 2016.

National Bank of Hungary decrees passed November and December 2014

Two settlement decrees state the definitions, formulas and steps of the calculation, in separate decrees for performing and non-performing loans. Decree on client communication details rules on timing, content and form of client information related to all aspects and effects of 'Curia laws'.

Conversion law of 2014:LXXVII (passed November 2014)

The concept is a compulsory conversion of foreign currency denominated consumer loans in-scope into HUF, at a rate fixed by the law. In scope are foreign currency denominated consumer mortgage loans and foreign currency denominated real estate leasing agreements. The effective conversion date is 1 February 2015.

The Act offers opt-out possibilities, so clients who meet certain conditions can stay in FX construction.

The fixed rate is spot rate as of 7 November 2014 ('FX rate fixation'):

EUR/HUF 308.97;

CHF/HUF 256.47;

JPY/HUF 2.163JPY.

The conversion was processed together with the settlement of compensation amount out of imposing unfair unilaterally modified interest, fee, charges and for realising bid/ask spread margin.

Act defines the calculation method of fair interest rates shall be applied after conversion, meaning 3 months BUBOR reference rate plus interest rate margin that may not exceed 4.5 % for housing mortgage loans and 6.5% for non-housing ones, but at least 1% in both cases. Current interest rate shall be applied only if fair one is less favourable for the clients.

Fair banking law LXXVIII of 2014 (passed December 2014)

Fair banking law is a modification of the Act on Consumer loans of 2009 CLXII, so all consumer loans and leasing agreements are in-scope, including the previous exemptions under Curia law and Settlement law. The three main areas of the Act are

- Fair way of client information
Providing general and personalised information to clients is prior to conclusion of contracts and publication on web-site or in branches.
- Fair way of setting interest, fees, charges

1. For deals having three years tenor or less the interest rate must be a fixed or alternatively can follow the structure of reference rate plus fixed margin.
No modification is possible during the life of the loan.
 2. For deals having a tenor over three years, the interest rate must be fixed for three year periods or alternatively can be defined as reference rate plus margin fixed for entire tenor, but at least for three year periods.
Bank is entitled to modify the fixed rate or fixed margin only four times during the tenor, based on the interest change indicator */ interest rate margin change indicator** approved and published by National Bank of Hungary.
Any other unilateral interest change is subject to National Bank of Hungary's pre-approval.
 - *interest change indicator*: indicator reflecting all interest changes (i.e. refinancing costs) out of the creditors' control
 - ** *interest rate margin change indicator*: indicator reflecting all interest rate margin changes (i.e. refinancing costs) out of the creditors' control
 3. Independently from the tenor of the contract:
Costs can be adjusted once a year by the official consumer price index.
Overdue interest is capped of 150% of the contractual interest rate plus 3 %.
- Unilateral modification
Exclusively for interest rate, interest rate margin, costs and fees, only in case if contract comprehensively includes the option and the objective conditions of unilateral amendment. Principle of symmetry is a must to be aligned with.

(iii) Further legislative measures in 2015 expanding the scope of conversion

FX car loan, financial leasing and unsecured loan conversion law CXLV of 2015 (passed 6 October 2015)

The Hungarian Government decided that FX denominated car loans and unsecured loans shall also be converted into HUF until the end of 2015.

The date of conversion regarding the existing contracts was the scheduled repayment day in November, but not later than 1 December 2015. The conversion regarding the claims arisen from a terminated contract had to be concluded until 31 January 2016 with a value date of 1 January 2016. Similarly to previous conversion, borrowers of terminated contracts are compensated in cash.

Exchange rate

The conversion has taken place at the average NBH rate of 19 August 2015 (287.2 CHF/HUF, 309.2 EUR/HUF). In the practice, the HUF conversion has been executed at the same FX rate as applied by the FX mortgage loans in February 2015 (FX fixation of 7 November 2014 see point (ii), page 8: 256.47 CHF/HUF, 308.97 EUR/HUF). The exposure has been reduced by the financial institution as a 'rebate' with the amount of the difference between the two rates.

Eligibility

The participation was voluntary, borrowers, either with existing or expired foreign currency based consumer loan contracts, had 30 days to decide whether to take this opportunity or not.

Modification of the consumer contracts

New amortization instalments shall be applied. The interest rates, fees and charges could not be changed. All the contracts had to be turned into annuity.

(iv) Effects of 2015 and 2016 legislations presented in financial statements

All related effects are presented under the name of 'FX settlement effect' in the financial statements of Erste Hungary.

The effects are summarised and presented under the following names:

FX 1: 2014 legislative measurements related to FX denominated loans (excluding HUF conversion of car loans, financial leasing and unsecured loans)

FX 2: 2014 legislative measurements related to HUF denominated loans

FX 3: 2015 legislative measurements related to FX denominated car loans, financial leasing and unsecured loans (conversion)

As of 31 December 2014 expected effects was presented in Erste Hungary's financial statement. The effective settlement and conversion date was in 2015.

As of 31 December 2015 the total effect of FX 3, while related to FX 1&2 the difference of estimated and realised / updated data are presented. Data as of 31 December 2015 still contains accounting estimation in the form of provision related to sold loans under FX 1&2 and closed loans related to FX 3.

As of 31 December 2016 FX3 related provisions were used and reversed.

Eligible customers were entitled to

- cash compensation related to closed loans
- reduction of exposure related to existing loans.

Summarising the effects

in HUF million	Notes	2015	2016
FX 1&2 settlement		3,400	540
FX 3 settlement	9	(2,070)	8
Total	9	1,330	548

(v) Tax implications of FX settlement

FX 1&2

The financial institution is allowed to reduce its corporate income tax from 2016 on with the differential amount of recalculated local business tax, innovation tax, corporate income tax and banking tax. Declared amount and recalculated amounts for the effected period, based on recalculated exposure are compared to define the amount of possible tax refund.

FX 3

The financial institution is allowed to reduce its taxes from 2016 on (corporate tax, special bank tax and financial transaction duty) with

- 50% of the amount of the rebate (difference between two rates) from 2016 on, without time limit
- 50% of the loss of interest and similar interest income between 2016-2018 due to the rebate
- losses arising from FX funding bought from NBH (based on estimated data) in case finally more than 2% of customers opted out from the scheme

The total calculated amount is 6.1 billion forint of which 3.5 billion forint is used in 2016, the remaining amount is planned to be used in 2017.

The calculation method is still subject of authority ruling request.

(vi) Risk management of affected portfolio

The past due items are part of the behaviour scoring calculation providing input for customer rating.

As the clients behaviour in substance did not change, after the settlement Erste Hungary kept the clients in the rating category they were before bid/ask spread, unfair interest and conversion effect (rating deterioration was allowed). A six-month monitoring period was applied for the affected performing clients to assess their new payment behaviour. For defaulted clients the monitoring period is 12 months and in case of contractual fulfilment of their payment obligation based on the reduced instalments the rating was changed to performing/non defaulted. As consequence of the applied monitoring period the improvement of the performing portfolio structure is realized in 2015, while the improvement on the non performing one was realised in 2016.

For the conversion involving car loan, financial leasing and unsecured loan conducted in December 2015, Erste Hungary had done 70 million Swiss franc spot conversion and swap deals with the National Bank of Hungary as well. As the eligible loans are considered as FX loans until their conversion, this hedging position was exempted from capital requirement as National Bank of Hungary deals and deals related to that could deducted from FX position.

(vii) Banking tax

The legal act related to the 'Banking tax' was subject to modification. Beside an unchanged basis (adjusted balance sheet total of business year 2009) the rate to apply for financial institutions above a balance sheet total of 50 billion forint in 2015 was 0.53%, while in 2016 0.24%. Up to 50 billion forint balance sheet total the rate was 0.15% in both years.

D. ACCOUNTING POLICIES

a) BASIS OF PREPARATION

The consolidated financial statements of Erste Hungary for the 2016 financial year and the comparable data for 2015 were prepared in compliance with applicable International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) published by the International Accounting Standards Board (IASB) and with their interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC, formerly Standing Interpretations Committee or SIC) as adopted by the European Union. Except as otherwise indicated, all amounts are stated in millions of Hungarian forint (HUF).

The consolidated financial statements have been prepared on a historical cost basis, except for available for sale investments, derivative financial instruments and other financial assets, liabilities held for trading and designated at fair value through profit or loss all of which have been measured at fair value.

The consolidated financial statements for the year ended 31 December 2016 were authorised for issue in accordance with a resolution of the directors on 7 April 2017.

Basis of consolidation

All subsidiaries controlled by Erste Hungary are consolidated in the financial statements. Subsidiaries are consolidated from the date on which control is transferred to the Bank. Control is achieved when Erste Hungary is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power to direct the relevant activities of the investee. Relevant activities are those which most significantly affect the variable returns of an entity.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the date of acquisition up to the date of disposal. The financial statements of the Bank's subsidiaries are prepared for the same reporting year as the Bank, using consistent accounting policies. All intra-group balances, transactions, income and expenses as well as unrealised gains and losses and dividends are eliminated. Non-controlling interests represent the portion of total comprehensive income and net assets, which are not attributable to owners of the parent.

b) ACCOUNTING AND MEASUREMENT METHODS

Reclassification and restatement

Reclassification

Government grant

Erste Hungary recognises government grant related to the National Bank of Hungary (NBH) security program.

NBH introduced a floating-rate-payer forint interest rate swap (IRS) facility with terms of three and five years starting from June 2014 and one with a term of ten years starting from July 2015. This facility applies some preferential elements to intensify usage of IRS tenders and also additional purchase of government securities by Banks. Banks are entitled to the preferential element if the government security portfolio is kept at a given level. In 2016 240 million forint is presented as government grant related to IRS. The 2015 amount equals to 37 million forint.

In 2015 the preferential gain was presented within 'Net trading and fair value result' and 'Derivatives'.

See the reclassification effect as below:

in HUF million	2015	2015 reclassified
Income statement		
Net trading and fair value result	(147)	(185)
Other operating result	2,790	2,827
Statement of financial positions		
Derivatives	10,846	11,161
Other liabilities	19,754	20,069

Details see in Note 9, page 34.

Restatement

In addition to the previously presented headquarter office building the Bank calculated its operating lease amount for the branches and multifunctional IT devices as well:

in HUF million	2015	2015 restated
< 1 year	1,237	3,946
1-5 years	4,950	11,515
> 5 years	619	1,705
0Total	6,806	17,166

Details see in Note 30b, page 54.

Foreign currency translation

The consolidated financial statements are presented in Hungarian forint (HUF) which is the functional currency of the parent entity. The functional currency is the currency of the primary business environment in which an entity operates.

For foreign currency translation, exchange rates quoted by the National Bank of Hungary are used. Transactions in foreign currencies are initially recorded at the functional currency exchange rate effective at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange at the balance sheet date. All resulting foreign exchange differences that arise are recognised in the Income Statement, in the Trading result. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using exchange rates as at the dates of the initial transactions. Differences arising from cash flow hedge are recognised in equity.

Financial instruments – recognition and measurement

A financial instrument is a contract which automatically produces a financial asset for the one company and a financial liability or equity instrument for the other. In accordance with IAS 39, all financial assets and liabilities – which include derivative financial instruments – are recognised in the Statement of Financial Position and measured in accordance with their assigned category.

Erste Hungary uses the following measurement categories:

- financial assets at fair value through profit or loss, including:
 - derivative instruments
 - other trading instruments
- financial assets – available for sale
- financial assets – held to maturity
- loans and receivables to credit institutions and customers
- financial liabilities at fair value through profit or loss
- financial liabilities at amortised cost

The Relationships between the Statement of Financial Position and measurement categories are described in the next table:

Statement of Financial Position	Measurement method	
	Fair Value	At amortised cost
ASSETS		
Cash and cash balances with central bank		x
Loans and receivables to credit institutions		x
Loans and receivables to customers		x
Financial assets – held for trading	x	
Financial assets - available for sale	x	
Financial assets - held to maturity		x
LIABILITIES		
Deposits from banks		x
Deposit from customers		x
Debt securities issued		x
Financial liabilities – held for trading	x	
Financial liabilities – designated at fair value through profit or loss	x	

(i) Date of recognition

Financial instruments are initially recognised when Erste Hungary becomes a party to the contractual provisions of the instrument. Regular way (spot) purchases and sales of financial assets are recognised at settlement date which is the date that an asset is delivered. Certain subsidiaries recognise financial instruments at trade date in their stand-alone statements, but these differences are reversed within the consolidation.

(ii) Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the management's intention for which the financial instruments were acquired and their characteristics. Financial instruments are measured initially at their fair value including transaction costs, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss.

(iii) Cash and cash equivalents with central bank

Cash and cash equivalents with central bank comprise cash on hand and current accounts with central banks. The Bank is obliged to maintain a minimum mandatory reserve at the central bank amounting to 2% of its domestic customers' deposits, foreign customers' FX deposits and foreign customers' forint deposits with maturities of less than one year. On 1st December 2016 central bank lowered the rate of minimum mandatory reserve to 1%. The obligation is fulfilled if the monthly average of this separate account reaches the calculated amount.

(iv) Financial assets and financial liabilities - Derivatives

Derivatives used by Erste Hungary include interest rate swaps, futures, forward rate agreements, interest rate options, currency swaps and currency options. Derivatives are measured at fair value. Changes in fair value are recognised in the Income Statement. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Derivatives, depending on their internal classification are disclosed as 'Financial asset – held for trading Derivatives' or 'Financial liabilities – held for trading Derivatives' or in case of items subject to hedge accounting disclosed as 'Derivatives – hedge accounting' assets or liabilities in the Statement of Financial Position.

(v) Other financial assets and other financial liabilities held-for-trading

Financial assets and financial liabilities held-for-trading are recorded at fair value in the Statement of Financial Position. Changes in fair value are reported in 'Net trading result'. Net interest from this portfolio is recognised in Net interest income, using the effective interest rate method. Included in held-for-trading are debt securities, equity instruments acquired or issued principally for the purpose of selling or repurchasing in the near term. They are presented as 'Financial assets – held for trading' or 'Financial liabilities – held for trading' in the Statement of Financial Position.

(vi) Financial assets – available for sale

Financial assets available for sale include equity and debt securities as well as other investments. Equity investments classified as available for sale are those which are neither classified as held-for-trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in market conditions.

After initial measurement, financial assets – available for sale are subsequently measured at fair value. Unrealised gains and losses are recognised directly in other comprehensive income and reported in the 'Available for sale - reserve' until the financial asset is disposed of or impaired. If financial assets available for sale are disposed of or impaired, the cumulative gain or loss previously recognised directly in other comprehensive income is reclassified to profit or loss and reported under 'Result from financial assets – available for sale'. In the Statement of Financial Position, available for sale financial assets are disclosed in 'Financial assets – available for sale'.

If the fair value of investments in non-quoted equity instruments cannot be measured reliably, they are recorded at cost.

Interest on available for sale financial assets is reported in the Income Statement as 'Net interest income', using the effective interest rate method. Dividend received on available for sale financial asset is reported in the income statement as 'Dividend income'.

(vii) Financial assets - held to maturity

Held to maturity financial investments reported as 'Financial assets – held to maturity' in the Statement of Financial Position are non-derivative financial assets, with fixed or determinable payments, and fixed maturities, if Erste Hungary has the intention and ability to hold them until maturity. After initial recognition held to maturity financial investments are subsequently measured at amortised cost including impairment. Interest earned on financial assets - held to maturity is reported in 'Net interest income', using the effective interest rate method. Losses arising from impairment of such investments are recognised in the income statement in 'Other operating result'. Realised gains or losses from selling are recognised in 'Gains / losses from financial assets not measured at fair value through profit or loss'.

If Erste Hungary were to sell or reclassify more than an insignificant amount of held-to-maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available for sale. Furthermore, Erste Hungary would be prohibited from classifying any financial asset as held to maturity during the following two years.

(viii) Loans and receivables

Loans and receivables to customers and Loans and receivables to credit institutions include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

After initial measurement, loans and receivables are subsequently measured at amortised cost including impairment. Interest income earned is included in 'Net interest income' in the income statement, using the effective interest rate method. Losses arising from impairment are recognised in the income statement under 'Net impairment loss on financial assets not measured at fair value through profit or loss'.

Securities issued by municipalities are classified into 'Loans and receivables to customers' and are recorded at amortised cost as there is no active or liquid market for them. Their impairment is reported under 'Net impairment loss on financial assets not measured at fair value through profit or loss'.

(ix) Deposits and other liabilities

Deposits and other liabilities are measured at amortised cost except for trading liabilities and derivatives measured at fair value through profit or loss. Beside these items, Erste Hungary designates securities into the measurement category 'at fair value through profit or loss'. Erste Hungary uses this category if such classification eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

Besides 'Derivatives' and 'Other trading liabilities' liabilities are reported as 'Deposits from banks', 'Deposits from customers' 'Debt securities issued'. Interest expenses incurred are reported in 'Net interest income' in the income statement, using the effective interest rate method.

Derecognition of financial assets and financial liabilities

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired; or
- as Erste Hungary has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either:
 - has transferred substantially all the risks and rewards connected with the ownership of the asset, or
 - has neither transferred nor retained substantially all the risks and rewards connected with the ownership of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

Reclassification of financial assets

From Trading portfolio

Erste Hungary evaluates its financial assets held for trading, other than derivatives, to determine whether the intention to sell them in the near term is still appropriate. When Erste Hungary is unable to trade these financial assets due to inactive markets and management's intention to sell them in the foreseeable future significantly changes, Erste Hungary may elect to reclassify these financial assets in rare circumstances. The reclassification to loans and receivables, available for sale or held to maturity depends on the nature of the asset. This evaluation does not affect any financial assets designated at fair value through profit or loss using the fair value option at designation.

From Available for sale portfolio

For a financial asset reclassification out of the Available for sale category any previous gain or loss on the asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest rate. Any difference between the new amortised cost (equal to fair value at reclassification) and the expected cash flow is also amortised over the remaining life of the asset using the effective interest rate method. If the asset is subsequently determined to be impaired then the amount recorded in equity is recycled to the Income Statement.

Reclassification is at the election of management and is determined on an instrument by instrument basis. Erste Hungary does not reclassify any financial instruments into the fair value through profit or loss category after initial recognition.

Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the Statement of Financial Position as Erste Hungary retains substantially all the risks and rewards of ownership. Such transactions are also known as 'repos' or 'sale and repurchase agreement'. The corresponding cash received is recognised in the Statement of Financial Position as an asset with a corresponding obligation to return it as a liability in the respective lines 'Deposits from banks' or 'Deposits from customers' reflecting the transaction's economic substance as a loan to Erste Hungary. The difference between the sale and repurchase prices is treated as interest expense and recorded in the line 'Net interest income' and is accounted for using the effective interest rate method. Financial assets transferred out by Erste Hungary under repurchase agreements remain on Erste Hungary's statement of financial position and are measured according to the rules applicable to the respective Statement of Financial Position item.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the Statement of Financial Position. Such transactions are also known as 'reverse repos'. The consideration paid is recorded in the Statement of Financial Position in the respective lines 'Loans and receivables to credit institutions' or 'Loans and receivables to customers', reflecting the transaction's economic substance as a loan by Erste Hungary. The difference between the purchase and resale prices is treated as interest income and recorded under 'Net interest income' and is accounted for using the effective interest rate method.

Securities lending and borrowing

In securities lending transactions, the lender transfers ownership of securities to the borrower on the condition that the borrower will retransfer, at the end of the agreed loan term, ownership of instruments of the same type, quality and quantity and will pay a fee determined by the duration of the lending. Similarly to 'reverse repos', the transfer of the securities to counterparties via securities lending does not result in derecognition unless the risks and rewards of ownership are also transferred. Securities borrowed are not recognised in the Statement of Financial Position, unless they are then sold to third parties.

Determination of fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The best indication of the fair value of financial instruments is provided by quoted market prices in an active market. Where quoted market prices in an active market are available, they are used to measure the financial instrument (level 1 of fair value hierarchy). The measurement of fair value at Erste Hungary is based primarily on external sources of data (stock market prices or broker quotes in highly liquid market segments). Where no market prices are available, fair value is determined on the basis of valuation models that are based on observable market information (level 2 of fair value hierarchy). In some cases, the fair value of financial instruments can be determined neither on the basis of market prices nor of valuation models that rely entirely on observable market data. In this case, individual valuation parameters not observable in the market are estimated on the basis of reasonable assumptions (level 3 of fair value hierarchy). This includes extrapolation of yield curves or volatilities, usage of historical volatilities, internal customer rating and internal estimations like PD sets (probability of default).

Derivatives

Erste Hungary employs only generally accepted, standard valuation models. Net present values are determined for linear derivatives (e.g. interest rate swaps, cross currency swaps, foreign exchange forwards and forward rate agreements) by discounting the recurring cash flows. Plain vanilla OTC options (on shares, currencies and interest rates) are valued using option pricing models of the Black-Scholes class. Erste Hungary uses only valuation models which have been tested internally and for which the valuation parameters (such as interest rates, exchange rates and volatility) have been determined independently.

Derivatives are presented in Level 2 unless the counterparty CVA (credit value adjustment) exceeds the limit of 30 million forint or the CVA influences the net present value over 20%.

Securities

Publicly quoted securities are transferred from Level 1 to Level 2 in case of trade frequency is over 1 month. If frequency exceeds 3 months, the instrument is transferred into Level 3.

The responsibility for valuation of a position measured at fair value is independent from the trading units.

Impairment of financial assets

Erste Hungary assesses at each balance sheet 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 assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated 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 payments 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.

If Erste Hungary determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

(i) Financial assets carried at amortised cost

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The calculation of the present value of the estimated future cash flows (discounted by the original effective interest rate) of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

In the case of loans and receivables, any impairment is reported in the allowance account included in 'Loan and receivables to customers' or 'Loan and receivables to credit institutions' in the Statement of Financial Position and the amount of the loss is recognised in the income statement under 'Net impairment loss on financial assets not measured at fair value through profit or loss'. Risk provisions for loans and receivables include specific risk provisions for loans and receivables for which objective evidence of impairment exists on individual basis. In addition, risk provisions for loans and receivables include portfolio risk provisions for which no objective evidence of impairment exists in single observation. For held to maturity investments impairment is recognised directly by reduction of the asset account and in the income statement under 'Other operating result'. Interest income for individually impaired assets continues to be accrued on the reduced carrying amount and is accrued using the interest rate used to discount the future cash flows for the purpose of measuring the impairment loss. Interest income is recorded as part of 'Net interest income'.

Loans together with the associated allowance are derecognised (written off) when there is no realistic prospect of future recovery and all collateral has been realised by Erste Hungary.

If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account in case of loans and receivables. In the case of held to maturity investments the carrying amount is increased or decreased. Decreases in impairment losses are reported in the same line of the income statement as the impairment loss itself.

Where possible, the bank seeks to restructure loans rather than take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

(ii) Financial assets - available for sale

In the case of debt instruments classified as available for sale, Erste Hungary assesses individually whether there is objective evidence of impairment based on the same criteria as for financial assets carried at amortised cost. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed (except for equity instruments, where no reversal is accepted) through the income statement in 'Net impairment loss on financial assets not measured at fair value through profit or loss'. Impairment losses and their reversals are recognised directly against the assets in the Statement of Financial Position.

Collateral valuation and management

Collateral valuation is based on current market prices, while taking into account an amount that can be recovered within a reasonable period. The internally acceptable collateral values are adjusted downward by valuation rates, reflecting any prior claims from other debtors, discounts by distressed realization price, respectively and any other limiting factors which would prevent Erste Hungary to collect the market price of collateral. The valuation processes are defined and implemented by authorized staff. Only independent appraisers not involved in the lending decision process are permitted to conduct real estate valuations, and the valuation methods to be applied are defined. All appraisers are certified by Erste Hungary and each is subject to a regular review. Erste Hungary removes appraisers should any concern about their objectivity or quality arise.

The revaluation of collateral is done periodically. In case of corporate the valuations, and revaluations are undertaken on a case by case basis. For retail residential real estate the individual valuation is performed within the loan application process, while in later periods a statistical method is used with a reference to market indexes. Apart from periodic revaluations, collateral is also assessed when information becomes available that indicates a decrease in the value of the collateral for exceptional reasons.

Erste Hungary reviewed its standards, processes and systems, spending special focus on collateral registration, valuation, insurance and Basel III eligibility. Numerous policies have been updated reflecting the lessons from the crisis as well as supervisory requirements. The Collateral Catalogue of Erste Hungary is fully aligned with the Erste Group Collateral Catalogue

Impairment of non-financial assets

Erste Hungary assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used.

Hedge accounting

Erste Hungary makes use of derivative instruments to manage exposures to interest rate risk and foreign currency risk. At inception of a hedge relationship, the Bank formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset the fair value changes of the hedging instrument in a range of 80% to 125%.

(i) Fair value hedge

Fair value hedges are employed to reduce market risk. For qualifying and designated fair value hedges, the change in the fair value of a hedging instrument is recognised in the income statement in the line 'Net trading and fair value result'. The change in the fair value of the hedged item attributable to the hedged risk is also recognised in the income statement in 'Net trading and fair value result' and the carrying amount of the hedged item has to be adjusted in the Statement of Financial Position. The hedged item for individual hedges is recorded together with underlying instrument on the respective Statement of Financial Position line. If the hedging instrument expires, is sold, is terminated or is exercised, or when the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. In this case, the fair value adjustment of the hedged item shall be amortised to the income statement in the 'Net interest income' until maturity of the underlying financial instrument (hedged item). The amortization of the fair value adjustment shall be done based on a recalculated effective interest rate at the date amortization begins. However, if, in the case of a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities, amortising using a recalculated effective interest rate is not practicable, the adjustment shall be amortized using a straight line method. If the hedged item is sold the hedging relationship is terminated at the date of sale. Any accumulated fair value adjustment in relation to the hedged risk of the hedged item (that adjusts the carrying amount of the hedged item) adjusts the net profit or loss from the sale of the hedged item. Accordingly this result is presented in same line as the result from the sale of the hedged item.

(ii) Cash flow hedge

Cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. Cash flow hedges are used to eliminate uncertainty in the future cash flows in order to stabilise net interest income. For designated and qualifying cash flow hedges, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and reported under the 'Cash flow hedge reserve'. The ineffective portion of the gain or loss on the hedging instrument is recognised in the income statement in the 'Net trading and fair value result'. When the hedged cash flow affects the income statement, the gain or loss on the hedging instrument is reclassified from other comprehensive income into the corresponding income or expense line in the income statement (mainly 'Net interest income'). When a hedging instrument expires, is sold, is terminated, is exercised, or when a hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated [IAS 39.101]. In this case, the cumulative gain or loss on the hedging instrument that has been recognised in other comprehensive income shall remain separately in 'Cash flow hedge reserve' until the transaction occurs. If the forecast transaction is no longer expected to occur, the cumulative gains or loss that had been recognised in other comprehensive income from the period when the hedge was effective shall be reclassified from equity to profit or loss as a reclassification adjustment.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the Statement of Financial Position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Leasing

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. A finance lease of Erste Hungary is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. The remaining lease agreements in Erste Hungary are classified as Operating leases.

The determination of whether an arrangement is a lease or it 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.

Erste Hungary as a lessor

The lessor in the case of a finance lease reports a receivable against the lessee amounting to the present value of the contractually agreed payments taking into account any residual value. Lease income is calculated using the implicit rate in the lease and presented as 'Net interest income'.

In the case of an operating lease the leased asset is reported by the lessor in 'property and equipment' and is depreciated in accordance with the principles applicable to the assets involved. Lease income is recognised on a straight-line basis over the lease term.

Lease agreements in which Erste Hungary is the lessor almost exclusively represent finance leases.

Erste Hungary as a lessee

From the side of a lessee, Erste Hungary has not entered into any leases fulfilling the conditions of finance leases. Operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

Property and equipment

Property and equipment – including buildings, furniture and equipment are measured at cost less accumulated depreciation and accumulated impairment in value. Borrowing costs for qualifying assets are capitalised into the costs of property and equipment.

Depreciation is calculated using the straight-line method to write down the cost of property and equipment to their residual values over their estimated useful lives. Land and works of art are not depreciated. The estimated useful lives are as follows:

	Useful life in years
Own land and buildings	16.67 or 50
Office and plant equipment / other fixed assets	3 - 7
IT assets (hardware)	2 - 7

Property and equipment is derecognised on disposal or when no future economic benefits are expected from their use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in 'Other operating result' in the Income Statement in the year the asset is derecognised.

Business combinations and goodwill

(i) Business combinations

Business combinations are accounted for using the acquisition method of accounting. This involves recognising identifiable assets (including previously unrecognised intangible assets such as customer relationships and brand) and liabilities (including contingent liabilities and excluding future restructuring) of the acquired business at fair value. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the identifiable net assets acquired, the discount on acquisition is recognised in Income Statement in the line 'Other operating result' in the year of acquisition.

(ii) Goodwill and impairment testing

Goodwill is not amortised but tested for impairment annually in November with any impairment determined recognised in the income statement.

Investment property

Investment property is property (land and buildings or part of a building or both) held for the purpose of earning rental income or for capital appreciation. In the case of partial own use, the property is investment property only if the owner-occupied portion is insignificant. Investments in land and buildings under construction, where the future use is expected to be the same as for investment property, are treated as investment property.

Investment property is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is measured at cost less accumulated depreciation and impairment. Rental income is recognised in the income statement under the line item 'Other operating result'. Depreciation is recognised using the straight-line method over an estimated useful life. The useful lives of investment properties are identical to those of buildings reported under property and equipment. Any impairment losses, as well as their reversals, are recognised under the income statement line item 'Other operating result'. Investment property is presented on the Statement of Financial Position under the line item 'Investment properties'.

Repossessed assets

Erste Hungary generally takes possession of such assets that are related to leasing contracts, loan contracts of property developments or when properties that previously served as collateral are taken over. Repossessed cars are classified in the 'Assets held for sale' category. Repossessed properties are classified under 'Other assets' as inventories and are recorded at the lower of cost or net realisable value.

Erste Hungary does not occupy repossessed assets for business use as it is the policy of Erste Hungary to dispose of such assets in an orderly fashion.

Repossessed properties are transferred into "Investment properties" if based on economic analysis there is no demonstrable prospective on a midterm basis to sell the property and loss minimizing measurements lead to beneficiary rental contracts continuously generating income over more than a year, relating of more than 50% of the rental potential of the property.

Non-current assets classified as held for sale

Non-current assets are classified as held for sale if they can be sold in their present condition and the sale is highly probable within 12 months of the classification as held for sale. Assets classified as held for sale are reported under the Statement of Financial Position as 'Assets held for sale', under the segment reporting 'Retail'. Non-current assets that are classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

A disposal group is a group of assets, possibly with associated liabilities, which an entity intends to dispose of in a single transaction. The measurement basis, as well as the criteria for classification as held for sale is applied to the group as a whole. Assets being part of a disposal group are reported under the Statement of Financial Position line 'Assets held for sale'. Plant and equipment once classified as held for sale are not depreciated.

Intangible assets

Erste Hungary's intangible assets mainly comprise of computer software. An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Bank.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

Intangible assets with finite lives are amortised over their useful economic life. The amortisation period and the amortisation method are reviewed at least at each financial year-end and adjusted if necessary. The amortisation expense on intangible assets with finite lives is recognised in the Income Statement under 'General Administrative expenses'.

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful lives. 'Software acquired' and 'Other intangible assets' are amortised over 3 - 15 years.

Financial guarantees

In the ordinary course of business, Erste Hungary gives financial guarantees, consisting of some types of letters of credit and guarantees. According to IAS 39 a financial guarantee is a contract that requires the guarantor to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with original or modified terms of a debt instrument. If Erste Hungary is in a position of being a guarantee holder, the financial guarantee is not recorded in the Statement of Financial Position but is taken into consideration as collateral when determining impairment of the guaranteed asset.

Erste Hungary as a guarantor recognises financial guarantees in the financial statements. Financial guarantees are initially measured at fair value as soon as Erste Hungary becomes a contracting party, i.e., when the guarantee offer is accepted. Generally the initial measurement is the premium received for a guarantee. If no premium is received at contract inception the fair value of a financial guarantee is nil, as this is the amount at which the transaction could be settled on a standalone arm's length transaction with an unrelated party. Subsequent to initial recognition, the Erste Hungary's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Defined employee benefit plans

The defined employee benefit plan operated by Erste Hungary is for jubilee benefits to which all employees are entitled. Jubilee benefits (long service/ loyal-service benefits) are gifts and vouchers tied to the length of employees' service to an employer. The entitlement to jubilee benefits is established by local policy which defines both the conditions of the entitlement and the related types of benefits. Erste Hungary does not operate any employee benefit plans for pensions and severance benefits.

Provisions

Provisions are recognised when Erste Hungary has a present obligation 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. In the Statement of Financial Position provisions are reported under 'Provisions'. They include credit risk provisions for off-balance-sheet transactions (particularly warranties, guarantees and other credit commitments) as well as provisions for litigations and restructuring. Expenses or income from releases relating to credit risk provisions for off-balance-sheet items are presented in the income statement as 'Other operating results'. The Bank recognised provision on unfair foreign exchange and interest rate practices. All other expenses or income from releases related to provisions are reported within 'Other operating result'.

Share-based payment transactions

Erste Hungary does not have its own share based payment plans, but Erste Group offered its own share ownership and share options to Erste Hungary's employees with conditions as defined by the Erste Group's Employee Share Ownership Plan - ESOP (cash settled) and the Management Share Option Plan - MSOP (equity settled), in the form of equity-settled transactions until 2011.

Taxes

(i) Current tax

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

Current taxes comprise income taxes such as corporate income tax, local business tax and local innovation tax.

(ii) Deferred tax

Deferred tax is recognised for temporary differences between the tax bases of assets and liabilities and their carrying amounts at the balance sheet date. Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences and unused tax losses, to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, and the carry forward of unused tax losses can be utilised. Deferred taxes are not recognised on temporary differences arising from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax assets 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 tax rates (and tax laws) that have been enacted at the balance sheet date.

Deferred tax relating to items recognised in other comprehensive income is also recognised in other comprehensive income and not in the income statement. Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxation authority.

(iii) Banking Tax

The Hungarian Parliament approved a new Act in August 2010 which provides a framework for the levying of a “banking tax” on financial institutions in the years 2010, 2011, 2012, 2013, extended to 2014 as well. According to this Act each financial institution - that already had a closed financial year and related financial statements on 1 July 2010 - would be subject to assessment and payment of the banking tax. The basis and the rate of the banking tax that is payable differs depending on the type of financial institution. The rates are uniformly based on statutory reported financial data of the reporting entity for the period ended 31 December 2009. For credit institutions the tax rates are 0.15% of adjusted total asset value for the first 50 billion forint; and 0.53% (0.5% in 2010) for the amount exceeds 50 billion forint. For investment companies the tax base is the income from investment service activities less expenses on investment service activities shown in the annual report by local GAAP for the year 2009 and the tax rate is 5.6 %.

In the case of leasing and factoring companies the tax base is the net interest income and the positive net commission and fee income for 2010 and 2011. From 2012 the net commission and fee income is allowed to reduce the tax base if it is negative. The tax rate is 6.5%.

As the banking tax is payable based on prior year non net income measures it does not meet the definition of income tax under IFRS and is therefore presented as an operating expense in the income statement. Losses generated by the scheme of “Measures related to customers of more than 90 days past due” were compensated through the 2012 banking tax, up to 30% of the recognised loss, equalling 1.3 billion forint.

Fiduciary assets

Erste Hungary provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its clients. Assets held in a fiduciary capacity are not reported in the financial statements, as they are not the assets of the Bank.

Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank’s shareholder.

Recognition of income and expenses

Revenue is recognised to the extent that it is probable that economic benefits will flow to the entity and the revenue can be reliably measured. As regards to the lines reported in the income statement their description and revenue recognition criteria are as follows:

(i) Net interest income and dividend income

Interest income or expense is recorded using the effective interest rate (EIR) method. The calculation includes origination fees resulting from the lending business as well as transaction costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses. Interest income from impaired loans is calculated by applying the original effective interest rate used to discount the estimated cash flows for the purpose of measuring the impairment loss.

Net interest income mainly includes interest income on loans and advances to credit institutions and customers, on balances with central banks and on bonds and other interest-bearing securities in all portfolios and include interest paid on deposits by banks and customer deposits and, debt securities in issue.

Dividend income includes current income from shares and other equity-related securities (especially dividends) as well as income from other investments in companies categorised as available for sale. Such dividend income is recognised when the right to receive the payment is established.

(ii) Net fee and commission income

Erste Hungary earns fee and commission income from a diverse range of services it provides to its customers. It includes income and expenses mainly from fees and commission payable or receivable for payment transfers, securities business and lending business, as well as from insurance brokerage and foreign exchange transactions.

Fees earned for the provision of services over a period of time are accrued over that period. These fees include guarantee fees, commission income from asset management, custody and other management and advisory fees.

Fee income earned from providing transaction services, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, is recognised on completion of the underlying transaction.

(iii) Net trading and fair value result

Represents results arising from trading activities and includes all gains and losses from changes in fair value. It also includes foreign exchange gains and losses.

(iv) Net impairment loss on financial assets not measured at fair value through profit or loss

This item includes allocations to and releases of specific and portfolio risk provisions for loans and advances for both on-balance-sheet and off-balance-sheet transactions. Also reported in this item are direct write-offs of loans and advances as well as recoveries on loans written off.

(v) General administrative expenses

General administrative expenses represent the following expenses accrued in the reporting period: personnel and other administrative expenses, as well as depreciation and amortisation. Not included is any impairment of goodwill.

Personnel expenses include wages and salaries, bonuses, statutory and voluntary social security contributions (cafeteria), staff-related taxes and levies. They also include expenses for severance payments and share based payment.

Other administrative expenses include information technology expenses, expenses for office space, office operating expenses, advertising and marketing, expenditures for legal and other consultants as well as sundry other administrative expenses. In addition, contribution to deposit insurance fund are presented in this category.

(vi) Other operating expenses

Other operating expenses encompass non-netting items, like levies on banking activities, local taxes, insurances.

(vii) Other operating result

Other operating result mainly reflects all other income and expenses not attributable to Erste Hungary's ordinary activities. This includes the write down or reversal of write down as well as results on the sale of property and equipment, and result of debt collection, income from the release of and expenses for allocations to other provisions, including provision for guaranteed and credit lines.

(viii) FX settlement effect

Effect of Curia laws of 2014 and further legal measurements expanding the scope of the conversion are separated from *Other operating expenses*, to keep the recurring items of the category comparable. Details see in section *C.MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS*, page 8 and in Note 9, page 34.

(ix) Government grant

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed. When the grant relates to an asset, it is recognised as income in equal amounts over the expected useful life of the related asset.

Erste Hungary recognises government grant related to assets, presented within line item 'Other operating result'. Until reasonable assurance earned government grant is presented as deferred income within line item 'Other liabilities'.

Details see in Note 9, page 34 and Note 26, page 47.

Significant accounting judgements, assumptions and estimates

The consolidated financial statements contain amounts that have been determined on the basis of judgements and by the use of estimates and assumptions. The estimates and assumptions used are based on historical experience and other factors, such as planning as well as expectations and forecasts of future events that are currently deemed to be reasonable. As a consequence of the uncertainty associated with these assumptions and estimates, actual results could in future periods lead to adjustments in the carrying amounts of the related assets or liabilities. The most significant use of judgment, assumptions and estimates are as follows:

Going concern

Erste Hungary's management has made an assessment of Erste Hungary's ability to continue as a going concern and has concluded that Erste Hungary has the resources to continue in business for the foreseeable future. The management is not aware of any material uncertainties that may cast significant doubt upon Erste Hungary's ability to continue as a going concern. Therefore, the consolidated financial statements are prepared on the going concern basis.

Fair value of financial instruments

Where the fair values of financial assets and financial 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 inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment is required to establish fair values. Disclosures for valuation models, fair value hierarchy and fair values of financial instruments can be found in Note 36) Fair value of financial and non-financial instruments.

Impairment of financial assets

Erste Hungary reviews its financial assets not measured at fair value through profit or loss at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. In particular, it is required to determine whether there is objective evidence of impairment as a result of loss event occurring after initial recognition and to estimate the amount and timing of future cash flows when determining the impairment loss. At defining the amount of impairment the fair value of the eventual collateral is taken into consideration, based on assumptions.

Disclosures concerning impairment are included in Note 35.6) Risk Management, Credit risk.

Impairment of non-financial assets

Erste Hungary reviews its non-financial assets at each balance sheet date to assess whether there is an indication of impairment loss which should be recorded in the income statement. Judgement and estimates are required to determine the value in use by estimating the timing and amount of future expected cash flows and the discount rates.

Deferred tax assets

Deferred tax assets are recognised in respect of tax losses and deductible temporary differences to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies. Disclosures concerning deferred taxes are included in Note 20) Tax assets and liabilities.

Leases

From Erste Hungary's perspective as a lessor, judgement is required to distinguish whether the lease is finance or operating lease based on the transfer of substantially all the risk and rewards from the lessor to the lessee.

Provisions

A provision is recognized by Erste Group when it has a present obligation as a result of a past event, 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.

In the Statement of Financial Position, provisions are reported under 'Other provisions'. They include credit risk provisions for off-balance-sheet transactions (particularly warranties and guarantees) as well as provisions for litigations and restructuring. Based upon historical experience and expert reports Erste Hungary assesses the likelihood and the amount of potential financial losses which are appropriately provided for.

Segment reporting

The bank's segmental reporting is based on the following operating segments: Retail, Small and Medium Enterprises (SME), Local Large Corporate (LLC), Group Large Corporate (GLC), Public Sector (PS), Commercial Real Estate (CRE), Group Markets Trading (GMT), Group Markets Financial Institutions (GMFI), Assets and Liabilities Management (ALM), Corporate Centre and Free capital.

Erste Hungary does not report its geographical markets because it primarily carries on its business activities in Hungary and has no significant activities abroad.

Segment results include revenue and expenses directly attributable to a segment and the relevant portion of revenue and expenses that can be allocated to a segment, whether from external transactions or from transactions with other segments of Erste Hungary. Unallocated items mainly comprise administrative expenses. Segment assets and liabilities comprise those operating assets and liabilities that are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

APPLICATION OF AMENDED AND NEW IFRS/IAS

The accounting policies adopted are consistent with those used in the previous financial year except for standards and interpretations that became effective for financial years beginning on or after 1 January 2016. As regards new standards and interpretations and their amendments, only those that are relevant for the business of Erste Hungary are listed below.

Effective standards and interpretations

The following standards and their amendments have become mandatory for our financial year 2016, endorsed by the EU:

- Amendments to IAS 1: Disclosure Initiative
- Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation
- Annual Improvements to IFRSs 2012-2014 Cycle

Amendments to IAS 1: Disclosure Initiative (IASB effective date: 1 January 2016).

Disclosure Initiative makes the following changes:

Materiality: The amendments clarify that (1) information should not be obscured by aggregating or by providing immaterial information, (2) materiality considerations apply to the all parts of the financial statements, and (3) even when a standard requires a specific disclosure, materiality considerations do apply.

Statement of financial position and statement of profit or loss and other comprehensive income: The amendments (1) introduce a clarification that the list of line items to be presented in these statements can be disaggregated and aggregated as relevant and additional guidance on subtotals in these statements and (2) clarify that an entity's share of OCI of equity-accounted associates and joint ventures should be presented in aggregate as single line items based on whether or not it will subsequently be reclassified to profit or loss.

Notes: The amendments add additional examples of possible ways of ordering the notes to clarify that understandability and comparability should be considered when determining the order of the notes and to demonstrate that the notes need not be presented in the order so far listed in paragraph 114 of IAS 1. The IASB also removed guidance and examples with regard to the identification of significant accounting policies that were perceived as being potentially unhelpful.

These changes and clarifications did not result in significant changes in the presentation of Erste Hungary's IFRS consolidated financial statements.

Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation (IASB Effective Date: 1 January 2016). Amendments to IAS 16 and IAS 38 were issued in May 2014 and are effective for annual periods beginning on or after 1 January 2016. The amendments prohibit the use of revenue-based depreciation for property, plant and equipment and significantly limiting the use of revenue-based amortisation for intangible assets.

Application of these amendments did not have a significant impact on Erste Hungary's financial statements.

Annual Improvements to IFRSs 2012-2014 Cycle (IASB effective date: 1 January 2016). In September 2014, the IASB issued a set of amendments to various standards. The amendments are effective for annual periods beginning on or after 1 January 2016. Application of these amendments did not have a significant impact on Erste Hungary's financial statements.

Standards and interpretations not yet effective

The standards, amendments and interpretations shown below were issued by the IASB, but are not yet effective.

Following standards, amendments and interpretations are already endorsed by the EU:

- IFRS 9: Financial Instruments
- IFRS 15: Revenue from Contracts with Customers including Amendments to IFRS 15: Effective date of IFRS 15

Following standards, amendments and interpretations are not yet endorsed by the EU:

- IFRS 16: Leases
- Clarifications to IFRS 15: Revenue from Contracts with Customers
- Amendments to IAS 12: Recognition of deferred tax assets for unrealised losses
- Amendments to IAS 7: Disclosure Initiative

IFRS 9: Financial Instruments (IASB Effective Date: 1 January 2018). IFRS 9 was issued in July 2014 and is effective for annual periods beginning on or after 1 January 2018. IFRS 9 addresses three main areas of accounting for financial instruments: classification and measurement, impairment and hedge accounting.

IFRS 9 introduces two classification criteria for financial assets: 1) an entity's business model for managing the financial assets, and 2) the contractual cash flow characteristics of the financial assets. As a result, a financial asset is measured at amortised cost only if both of the following conditions are met: a) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal outstanding and b) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows. Measurement of a fair value through other comprehensive income is applicable to that meet condition a) but the business model applied to them is focused both on holding the assets to collect contractual cash flows and selling the assets. All other financial assets are measured at fair value with changes recognised in profit or loss. For investments in equity instruments that are not held for trading, an entity may make an irrevocable election at initial recognition to measure them at fair value with changes recognised in other comprehensive income.

IFRS 9 does not change classification and measurement principles for financial liabilities compared to IAS 39. The only change is related to financial liabilities designated at fair value through profit or loss (fair value option). The fair value changes related to the credit risk of such liabilities will be presented in other comprehensive income- (unless such treatment would create or enlarge accounting mismatch in profit or loss, in which case these changes are presented in profit or loss as well). IFRS 9 provides an option to apply this requirement early, however Erste Hungary does not intend to make use of this option.

The standard provides a uniform impairment model applied to both financial assets and off-balance sheet credit risk bearing exposures (loan commitments and financial guarantees). At initial recognition of financial instruments loss allowance to reflect credit loss is recognised in the form of 12-month expected credit losses. Lifetime expected credit losses are to be recognised for all instrument whose credit risk increases significantly after initial recognition. Furthermore the standard clarifies the rules for accounting for gains and losses resulting from modification of contractual conditions of financial assets.

IFRS 9 provides an accounting policy choice in the area of hedge accounting. Thus, upon adoption of IFRS9, entities can either (a) start with full application of the hedge accounting requirements of IFRS 9, (b) start with limited application of the hedge accounting requirements of IFRS 9 by continuing to apply IAS39 to the specific case of fair value hedges of interest rate exposure of a portfolio of financial assets or financial liabilities, or (c) continue with full application of the hedge accounting requirements of IAS39. Erste Hungary plans to implement the third choice, although having no hedge accounting item in the year of 2016. However, some actions are expected to be necessary in order to address additional disclosures that will be required based on IFRS 7 after adoption of IFRS 9.

Based on the accounting policy choice embedded into the transition requirements of IFRS 9, Erste Hungary will not restate comparative information upon initial application of IFRS 9. Instead, the one-off impact from initial application of IFRS 9 will be reflected in the opening equity as of the initial application date.

During the year 2016, Erste Hungary has completed the development of business requirements documentation addressing the changes in policies, procedures, processes and systems, assessed as necessary in preparation for transition to IFRS 9 on 1 January 2018. On this basis, following Erste Group requirements, Erste Hungary started the preparation in terms of adapting existing local solutions to the Erste Group-level requirements. As part of this effort, iterative financial impact studies (notably with regards to classification/measurement and impairment of financial assets but gradually also with regards to regulatory capital and ratios) continued and are planned to be further refined throughout the first half of 2017. Starting with the second half of 2017 a fully-fledged parallel run of the “as is” IAS 39 and the “to be” IFRS9 driven processes for classification, measurement, impairment and disclosure/reporting for financial instruments is planned. At the same time, Erste Hungary acknowledges that the above mentioned financial impact assessments and the simulated IFRS 9-driven outputs throughout the parallel run will bear an inherent degree of approximation, that is expected to reduce along with different IFRS 9-driven functionalities being implemented, tested and transferred from testing to the bank’s operating systems, at the level of each affected group entity.

On this basis, Erste Hungary upholds its previous expectations that this standard will have a significant effect on balance sheet items and measurement methods for financial instruments.

Thus, in the area of classification and measurement, Erste Hungary originally identified a risk that part of its loan portfolio will have to be measured at fair value through profit or loss, due to the contractual cash flow characteristics, bearing interest rates featuring imperfections. On the other hand, some debt securities currently measured at fair value through other comprehensive income may be measured at amortised cost due to the ‘held-to-collect contractual cash’ flows business model applied to them.

In the area of expected credit loss modelling and ensuing impairment loss, the Erste Hungary believes that one of the key drivers of the expected impact from adopting the new impairment model required by IFRS 9 is the assessment of significant increase in credit risk for exposures that are not identified as credit-impaired. In this respect, across portfolios and product types, quantitative indicators defined for assessing significant increase in credit risk will include adverse change in lifetime probability of default and days-past-due in excess of 30 days. Qualitative indicators will include specific early-warning-system risk type flag (adversely changing since initial recognition), specific forbearance type flag (adversely changing since initial recognition) or work-out transfer flag being assigned. Some of the qualitative indicators (assignments of some specific flag types) will inherently rely on experienced credit risk judgment being exercised adequately and timely. The related credit risk controlling policies and procedures (most of them already in place, some of them in progress of being adapted in preparation for IFRS 9) will ensure the necessary governance framework. Besides the qualitative indicators defined on client level, it is planned to use and perform the assessment of significant increase in credit risk on portfolio level if the increase in credit risk on individual instrument or client level is only available with a certain time lag. The portfolio triggers should cover the unexpected increase in credit risk on portfolio level. However, the exact definition of such portfolio triggers has yet to be stabilized. Also, Erste Hungary believes that another significant driver of the expected impact from adopting the IFRS 9 impairment model is incorporation of forward-looking macro-economic information. In this respect, the Erste Group has developed a methodology for lifetime probabilities of default calculation that requires the application of a macroeconomic overlay. That is, the probabilities of default are modified by using a macroeconomic function as estimated for stress testing purposes (i.e. function linking selected macroeconomic variables with probabilities of default). In consideration of these methodological requirements, credit loss allowances are expected to increase more than insignificantly for some non-defaulted exposures.

Also, Erste Hungary expects that the structure of the financial statements (both main components and explanatory notes) will have to be adapted, notably in the light of the new reporting and disclosure requirements of IFRS 7, as triggered by IFRS 9. Such adaptations would also consider any new regulatory reporting requirements (notably FINREP related) which EU or national regulators may contemplate as part of preparing for initial application of IFRS 9 at the level of the wider European and national banking sector.

IFRS 15 Revenue from Contracts with Customers (IASB Effective Date: 1 January 2018).

IFRS 15 was issued in May 2014 and is effective for annual periods beginning on or after 1 January 2018. Clarifications to IFRS 15 were issued in April 2016. IFRS 15 specifies how and when an entity recognises revenue from contracts with customers. It also requires such entities to provide users of financial statements with more informative and more relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. Also in the areas of variable considerations and capitalisation of cost IFRS 15 provides modified regulations. As the standard is not focused on recognition of revenues from financial services, application of this standard is not expected to have a significant impact on Erste Group's financial statements.

IFRS 16 Leases (IASB Effective Date: 1 January 2019).

In January 2016, the IASB issued IFRS 16 being effective for annual periods beginning on or after 1 January 2019. IFRS 16 specifies the depiction of lease arrangements in the financial statements. Compared to the previous standard IAS 17, there is a fundamental alteration in respect of the recognition of operating leasing arrangements for the lessee. As defined in IFRS 16, the standard requires the lessee to recognize a right of use asset on the debit side of the balance sheet as well as a corresponding lease liability on the credit side of the balance sheet except for immateriality in cases of short term leasing arrangements and small ticket leasing arrangements for low-value assets. By contrast, accounting changes for the lessor are only minor compared to IAS 17. Compared to IAS 17 the notes will be much more comprehensive under IFRS 16.

Amendments to IAS 12: Recognition of deferred tax assets for unrealised losses (IASB effective date: 1 January 2017).

Amendments to IAS 12 were issued in January 2016 and are effective for annual periods beginning on or after 1 January 2017. The amendments clarify that unrealised losses on debt instruments measured at fair value in the financial statements but at cost for tax purposes can lead to deductible temporary differences. The amendments also clarify that not the carrying amount but the tax base of an asset is the relevant base for the estimate of future taxable profits and that the carrying amount is not the ceiling to be used for the calculation. When comparing deductible temporary differences with future taxable profits, the future taxable profits exclude tax deductions resulting from the reversal of those deductible temporary differences.

The impact on the financial statements will be evaluated, but it is not expected that these amendments will have a significant impact.

Amendments to IAS 7: Disclosure Initiative (IASB effective date: 1 January 2017).

Amendments to IAS 7 were issued in January 2016 and are effective for annual periods beginning on or after 1 January 2017. The amendments require disclosure of information enabling users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

Application of these amendments is not expected to result in new disclosures since financing activities in the cash flow statement of Erste Hungary relate only to equity and not to financial liabilities.

E. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1) Net interest income

in HUF million	2015	2016
Interest income		
Financial assets - held for trading	4,197	4,046
Financial assets - available for sale	516	1,606
Financial assets - held to maturity	11,540	11,830
Loans and receivables	74,905	54,720
Total interest income	91,158	72,202
Interest expenses		
Financial liabilities measured at fair value through profit and loss	(2,762)	(1,359)
Financial liabilities measured at amortised cost	(26,393)	(14,047)
Total interest expense	(29,155)	(15,406)
Net interest income	62,003	56,796

The interest income related to the non-performing portfolio is 3,642 million forint in 2016 and 7,390 million forint in 2015.

2) Net fee and commission income

in HUF million	2015	2016
Lending business	1,869	2,129
Payment transfers	20,647	21,955
Card business	10,286	9,993
Securities business	13,907	14,297
Investment fund transactions	6,334	5,819
Custodial fees	1,531	1,566
Brokerage	6,043	6,911
Insurance brokerage	2,167	2,458
Building society brokerage	314	178
Investment banking business	1,000	2,440
Other fee and commission income	1,624	1,053
Fee and commission income - total	51,815	54,502
Lending business	(1,314)	(1,668)
Payment transfers	(1,833)	(2,008)
Card business	(3,439)	(3,820)
Securities business	(2,105)	(2,545)
Investment fund transactions	(758)	(759)
Custodial fees	(197)	(187)
Brokerage	(1,150)	(1,599)
Insurance brokerage	(10)	(18)
Building society brokerage	(109)	(19)
Investment banking business	(36)	(66)
Other fee and commission expense	(378)	(198)
Fee and commission expense - total	(9,224)	(10,340)
Net fee and commission income	42,591	44,161

3) Dividend income

in HUF million	2015	2016
Financial assets - available for sale	55	28
Dividend income	55	28

4) Net trading and fair value result

in HUF million	2015 reclassified	2016
Securities	1,774	3,601
Derivatives	(2,589)	3,676
Foreign exchange transactions	629	(539)
Net trading and fair value result	(185)	6,738

Net result of financial instrument valued at fair value through profit and loss

Net trading and fair value result	(185)	6,738
Net interest income	1,435	2,688
Securities	1,210	3,178
Derivatives	225	(490)
Net result of financial instrument valued at fair value through profit and loss	1,250	9,426

5) Rental income from investment properties & other operating leases

in HUF million	2015	2016
Investment properties	273	1,236
Rental income from investment properties & other operating leases	273	1,236

6) General administrative expenses

in HUF million	2015	2016
Personnel expenses	(26,226)	(28,501)
Wages and salaries	(19,282)	(21,025)
Compulsory social security	(5,870)	(6,343)
Other personnel expenses	(1,074)	(1,133)
Other administrative expenses	(23,108)	(26,064)
Deposit insurance contribution	(1,342)	(2,300)
IT expenses	(7,202)	(8,105)
Expenses for office space ¹⁾	(6,805)	(6,496)
Office operating expenses	(1,979)	(2,487)
Advertising/marketing	(2,032)	(2,186)
Legal and consulting costs	(1,603)	(1,819)
Sundry administrative expenses	(2,146)	(2,671)
Depreciation and amortisation	(6,401)	(6,340)
Software and other intangible assets	(4,315)	(4,012)
Owner occupied real estate	(587)	(700)
Investment properties	(154)	(293)
Office furniture and equipment and sundry property and equipment	(1,345)	(1,336)
General administrative expenses	(55,735)	(60,905)

1) 'Expenses for office space' includes rental expense related to headquarter office building and branches, presented in Note 30b, page 54 as operating leasing.

7) Average number of employees during the financial year (weighted according to the length of employment)

in Full Time Employee	2015 year end	2015 average	2016 year end	2016 average
Erste Bank Hungary	2,605	2,701	2,646	2,677
Fully consolidated subsidiaries	209	200	227	225
Erste Befektetési Zrt.	146	140	147	149
Erste Lakáslízing Zrt.	0	0	0	0
Erste Ingatlan Kft.	38	35	28	33
Erste Lakástakarék Zrt.	24	24	38	33
Erste Jelzálogbank Zrt.	1	1	13	10
Total	2,814	2,901	2,873	2,902

8) Net impairment loss on financial assets not measured at fair value through profit or loss

in HUF million	2015	2016
Available- for-sale financial assets	0	(309)
Loans and receivables to customers	(41,807)	(4,988)
Allocation to risk provisions	(85,411)	(46,832)
Release of risk provisions	38,411	48,755
Direct write-offs	(646)	(9,142)
Recoveries recorded directly to the income statement	5,838	2,230
Net impairment loss on financial assets not measured at fair value through profit or loss	(41,807)	(5,297)

9) Other operating expenses, Other operating result and FX settlement loss

in HUF million	2015 reclassified	2016
Banking tax	(14,532)	(6,140)
Transaction tax	(11,491)	(11,703)
Resolution fund	(661)	(559)
Other levies on banking activities	(213)	(238)
Other taxes	(812)	(555)
Insurances	(671)	(657)
Other	(85)	(41)
Other operating expenses	(28,466)	(19,893)

in HUF million	2015 reclassified	2016
(Allocation)/release of provision for guarantees and credit lines	(5,910)	(14,373)
Result from sales of other assets	2,147	3,643
Result from sales of properties/movables	46	16
Impairment on inventories and receivables ¹⁾	(314)	(1,327)
Impairment on intangibles	(136)	(128)
Impairment on investment properties	(300)	(122)
(Allocation)/release of other provisions/risks	(976)	(1,398)
Result of workout activities	(974)	(1,155)
FV correction ²⁾	(867)	171
Income from upgrade on loans previously subject to FX settlement ³⁾	9,023	33,848
Government grant ⁴⁾	37	1,657
Other ⁵⁾	1,050	284
Other operating result	2,827	21,117

1) The impairment allocation for repossessed assets amounted to 1.1 billion forint recognised in "Impairment on inventories and receivables" (354 million forint in 2015). There was no reversal due to revaluation. The use of impairment of 2.8 billion forint (1 million forint in 2015) is shown in 'Result from sales of other asset' together with the expenses of derecognition and the income of the sale.

2) National Bank of Hungary (NBH) launched the „Funding for growth scheme” April 2013. Under the scheme NBH made refinancing available to Hungarian lenders for new SME loans and the conversion of SMEs' foreign currency-denominated loans into forints, at 0% rate. Rates on the loans were capped at 2.5%, well under the 3.80% base rate of April 2013.

The effect of initial measurement was presented as of 31 December 2013 7,482 million forint loss on assets and 7,482 million forint gain on refinancing totalling to zero.

As of 31 Dec 2013 the initial measurement of municipality securities kept in 'Loans and receivables' portfolio taken over by government and converted into forint resulted in 1.6 billion forint gain.

The gain of 171 million forint presented in 2016 is coming from the unamortised initial FV correction related to derecognition of three municipality bonds taken over by the Government.

3) Details of FX settlement's legal background see in section C. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS (ii) Legislative measures in 2014 having the same general goals as 'Home rescue plan' of 2011 did, page 11 and (iii) Further legislative measures in 2015 expanding the scope of conversion, page 11.

FX portfolio subject to legally obliged conversion into forint were derecognised and recognised as new loans. There was no impairment presented at recognition, so upgrade of clients out of positive change in CF expectation was recognised as increase of exposure in 'Loans and receivables to customers' in statement of financial position and in 'Other operating result' in income statement.

4) Conforming to its accounting policies (see chapter D. Accounting policies, page 13) Erste Hungary recognises government grant in 'Deferred income' till the reasonable assurance on realisation. After reasonable assurance earned, realised government grant is presented within 'Other operating result'.

Details on balances regarding government grant see in Note 26, page 47.

Erste Hungary recognises government grant related to the following:

- National Bank of Hungary (NBH) security program
NBH introduced a floating-rate-payer forint interest rate swap (IRS) facility with terms of three and five years starting from June 2014 and one with a term of ten years starting from July 2015. This facility applies some preferential elements to intensify usage of IRS tenders and also additional purchase of government securities by Banks. Banks are entitled to the preferential element if the government security portfolio is kept at a given level. In 2016 240 million forint is presented as government grant related to IRS. The 2015 amount equals to 37 million forint.
- NBH SME lending program (PHP)
NBH introduced a lending activity linked floating-rate-payer forint interest rate swap (HIRS) with terms of one and three years starting from February 2016. Banks are entitled to the preferential gain if criteria combining growth and stability elements related to lending activity in SME sector are met. In 2016 1,417 million forint is presented as government grant related to HIRS.

5) Includes 620 million forint investment property expense (223 million forint in 2015).

in HUF million	2015	2016
FX 1&2 settlement	3,400	540
FX 3 settlement	(2,070)	8
FX settlement effect	1,330	548

See detailed explanation in section C. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS, Summarising the effects, page 8.

10) Taxes on income

Taxes on income are made up of current taxes on income calculated in each company based on the results reported for tax purposes, prior period taxes, and the change in deferred taxes.

Depending on the level of profitability from the second half of 2010 the corporate tax rate has been reduced to a minimum of 10% of the adjusted amount of profit before tax. The portion of the profit before tax of a company which is below 500 million forint is charged with a rate of 10% corporate income tax. If the profit before tax of a company is above this amount the corporate income tax rate is 19% for the portion of the profit above 500 million forint.

Corporate income tax legislation relative for 2017 business year is published and known by the time of issuance of 2016 financial statement. Two-phase progressive tax rate is changed to general 9% rate.

Conforming to that, deferred tax was calculated by applying the 19% tax rate for 2015 and 9% for 2016.

Tax implications of FX settlement

FX 1&2

The financial institution is allowed to reduce its corporate income tax from 2016 on with the differential amount of recalculated local business tax, innovation tax, corporate income tax and banking tax. Declared amount and recalculated amounts for the effected period, based on recalculated exposure are compared to define the amount of possible tax refund.

FX 3

The financial institution is allowed to reduce its taxes from 2016 on (corporate tax, special bank tax and financial transaction duty) with

- 50% of the amount of the rebate (difference between two rates) from 2016 on, without time limit
- 50% of the loss of interest and similar interest income between 2016-2018 due to the rebate
- losses arising from FX funding bought from NBH (based on estimated data) in case finally more than 2% of customers opted out from the scheme

The total calculated amount is 6.1 billion forint of which 3.5 billion forint is used in 2016, the remaining amount is planned to be used in 2017.

The calculation method is still subject of authority ruling request.

Details see in part C. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS, page 8.

in HUF million	2015	2016
Current tax expense / income		
Current period taxes	(3,552)	(3,988)
of which local business tax	(2,814)	(3,041)
of which local innovation tax	(423)	(450)
Deferred tax expense / income		
Current period deferred tax benefit / (expense)	112	(89)
Total	(3,440)	(4,077)

The following table reconciles income taxes as reported in the income statement.

in HUF million	2015	2016
Profit or loss before tax	(18,571)	47,420
At statutory income tax rate (19% both years)	3,528	(9,010)
Income not subject to tax	19,527	1,703
Non tax deductible expenses	(16,827)	(1,730)
Local business and innovation tax	(3,236)	(3,843)
Effect of positive tax base of subsidiaries	(465)	-
Not recognised deferred tax on statutory profit or loss	(4,140)	-
Tax loss carry forward usage	-	3,641
Tax refund related to FX settlement ¹⁾	-	3,521
Other	(1,827)	1,641
Total tax losses	(3,440)	(4,077)

1) Details see in part C (v.), page 12.

At 31 December 2016 the tax loss carried forward amounts to 190,938 million forint. (2015: 209,080 million forint, respectively)

Using the tax loss carried forward is based on the following rules:

- Tax loss carry forwards arisen till 31 December 2014 and before are consumable for a limited period of 10 years, till 31 December 2025 (164,916 million forint);
- Tax loss carry forwards after 31 December 2014 is consumable for a limited period of 5 years, till 31 December 2020 (26,022 million forint).

Annually used tax loss carry forward amount could be only 50% of the profit before tax. Former tax loss carry forward amounts must be utilised first.

11) Cash and cash balances with central bank

in HUF million	2015	2016
Cash on hand	16,131	17,886
Cash balances at central banks	81,339	77,116
Other demand deposits	14,399	11,048
Cash and cash balances with central bank	111,869	106,050

The Bank is obliged to keep a minimum mandatory reserve at the central bank amounting to 2% (from 1st of December 2016 1%) of its domestic customers' deposits, foreign customers' FX deposits and foreign customers' forint deposits with maturities less than one year. The average of monthly mandatory minimum reserves at 31 December 2015 and 31 December 2016 was 26.13 billion forint and 6.23 billion forint respectively. The minimum mandatory reserve balances are included within the above balances of cash and balances with central banks.

12) Derivatives – held for trading

in HUF million	2015 reclassified				2016			
	Positive fair value		Negative fair value		Positive fair value		Negative fair value	
	Carrying amount	Notional amount						
Derivatives – held for trading	11,161	1,851,945	20,566	1,861,899	15,397	2,156,052	11,337	2,161,122
Interest rate swaps	3,496	351,248	3,148	351,248	7,939	713,466	4,017	713,466
Currency swaps	4,844	1,022,401	14,848	1,032,350	4,017	801,562	3,944	801,254
Currency forward rate agreement	1,725	380,276	1,341	380,075	2,223	479,308	2,175	479,508
Currency futures	17	7,601	211	7,890	96	6,454	26	6,447
Interest rate options	109	8,545	120	8,545	97	8,506	107	8,506
Currency options	935	80,799	866	80,799	1,005	145,166	1,037	145,168
Other agreements	36	1,075	31	991	20	1,590	31	6,773

13) Other trading assets

in HUF million	2015	2016
Equity instruments	769	1,401
Debt securities	57,264	116,257
General governments	57,204	116,055
Credit institutions	60	202
Other financial corporations	1	-
Other trading assets	58,034	117,658

14) Financial assets - available for sale

in HUF million	2015	2016
Equity instruments ¹⁾	5,480	2,820
Debt securities	84,075	134,929
General governments	58,299	110,356
Other financial corporations	25,777	24,573
Financial assets - available for sale	89,555	137,749

1) Equity instrument category is mainly driven by the revaluation of the participation was due to a purchase offer posted by VISA Inc. in 2015. The proposed offer comprises a combination of an initial cash payment combined with preferred shares of VISA Inc. and a potential earn out payment in 2020. All these elements have been considered in the determination of the fair value. As significant input parameters for the fair value determination could not be derived from external observable parameters, it was necessary to include assumptions and estimations in the determination of the fair value. The purchase was realised in 2016, the realised gain of 4 billion forint is presented in line item 'Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net'. The new shares are presented in a value of 857 million forint as 31 December 2016.

15) Financial assets – held to maturity

in HUF million	Gross carrying amount		Collective allowances		Net carrying amount	
	2015	2016	2015	2016	2015	2016
General governments	290,152	432,142	-	-	290,152	432,142
Credit institutions	4,579	4,526	-	-	4,579	4,526
Total	294,731	436,668	-	-	294,731	436,668

16) Securities

in HUF million	Loans and receivables to customers and credit institutions				Other trading assets		Financial assets				Total
	Available for sale		Held to maturity								
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	
Bonds and other interest-bearing securities	6,975	3,959	57,265	116,257	84,075	134,929	294,731	436,668	443,046	691,813	
Listed	-	-	57,065	100,058	58,299	110,356	266,135	414,823	381,498	625,237	
Unlisted	6,975	3,959	200	16,200	25,777	24,573	28,596	21,845	61,548	66,576	
Equity-related securities	-	-	769	1,401	4,696	2,041	-	-	5,465	3,442	
Listed	-	-	765	1,388	-	-	-	-	765	1,388	
Unlisted	-	-	5	13	4,696	2,041	-	-	4,700	2,054	
Equity holdings	-	-	-	-	784	779	-	-	784	779	
Total	6,975	3,959	58,034	117,658	89,555	137,749	294,731	436,668	449,295	696,035	

17) Loans and receivables to credit institutions

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
As of 31 December 2016				
Loans and receivables	145,499	-	-	145,499
Central banks	76,579	-	-	76,579
Credit institutions	68,920	-	-	68,920
Total	145,499	-	-	145,499

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
As of 31 December 2015				
Loans and receivables	278,436	-	-	278,436
Central banks	234,595	-	-	234,595
Credit institutions	43,841	-	-	43,841
Total	278,436	-	-	278,436

18) Loans and receivables to customers

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
As of 31 December 2016				
Debt securities with customers	4,225	-	(266)	3,959
General governments	2,818	-	(82)	2,735
Non-financial corporations	1,407	-	(184)	1,224
Loans and advances to customers	1,096,210	(62,935)	(16,002)	1,017,273
General governments	540	(0)	(4)	536
Other financial corporations	31,551	(9)	(126)	31,416
Non-financial corporations	385,273	(21,443)	(8,510)	355,320
Households	678,847	(41,483)	(7,363)	630,001
Total	1,100,435	(62,935)	(16,269)	1,021,232

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
As of 31 December 2015				
Debt securities with customers	12,013	(4,388)	(649)	6,975
General governments	3,085	-	(439)	2,647
Non-financial corporations	8,927	(4,388)	(210)	4,329
Loans and advances to customers	1,117,285	(99,899)	(17,760)	999,627
General governments	22,241	(2)	(14)	22,226
Other financial corporations	20,755	(382)	(141)	20,232
Non-financial corporations	330,384	(39,899)	(9,191)	281,294
Households	743,905	(59,616)	(8,414)	675,875
Total	1,129,298	(104,287)	(18,409)	1,006,602

Allowances for loans and receivables to customers**Risk provisions 2016**

in HUF million	01.01.2016	Allocation	Use	Release	Interest income from impaired loans	Exchange rate effect	31.12.2016
Specific provisions	104,288	38,619	(37,483)	(38,477)	(3,642)	(369)	62,936
Portfolio provisions	18,408	8,213	-	(10,278)	-	(74)	16,268
Risk provisions for loans and advances	122,696	46,832	(37,483)	(48,755)	(3,642)	(443)	79,203

Risk provisions 2015

in HUF million	01.01.2015	Allocation	Use	Release	Interest income from impaired loans	Exchange rate effect	31.12.2015
Specific provisions	212,957	75,366	(153,271) ¹⁾	(26,139)	(7,390)	2,765	104,288
Portfolio provisions	20,579	10,045	-	(12,273)	-	58	18,408
Risk provisions for loans and advances	233,536	85,411	(153,271)	(38,411)	(7,390)	2,823	122,696

1) Includes the use of provision at the derecognition of the FX mortgage portfolio at the legally obliged conversion into forint. Detailed explanation see in section C. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTION, page 8. FX portfolio subject to legally obliged conversion into forint were derecognised and recognised as new loans.

19) Fixed assets movement

Movements in fixed assets schedule

COST in HUF million	Software acquired	Other intangi- ble assets (licenses, patents, etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties
Value 01.01.2016	32 354	2 834	9 037	5 245	8 867	58 337	11 659
Additions	9 399	29	788	632	1 075	11 923	111
Transfer	-	-	-	-	-	-	-
Disposals	(642)	-	(44)	(236)	(104)	(1 026)	(14)
Reclassification	(46)	(3)	3	9	43	6	54
Value 31.12.2016	41 064	2 860	9 785	5 650	9 880	69 239	11 810

DEPRECIATION AND IMPAIRMENT in HUF million	Software ac- quired	Other intangi- ble assets (licenses, patents, etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties ¹⁾
Value 01.01.2016	20 351	1 796	3 547	4 010	7 002	36 706	734
Additions	3 687	325	700	474	867	6 054	293
Transfer	-	-	-	-	-	-	-
Disposals	(642)	-	(29)	(182)	(101)	(954)	-
Reclassification	-	1	-	6	(2)	6	42
Impairment	156	(59)	-	-	31	128	122
Value 31.12.2016	23 552	2 063	4 219	4 308	7 798	41 939	1 191

NET CARRYING AMOUNT in HUF million	Software ac- quired	Other intangi- ble assets (licenses, patents, etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties
Value 01.01.2016	12 003	1 038	5 491	1 235	1 864	21 631	10 926
Value 31.12.2016	17 513	797	5 567	1 342	2 082	27 301	10 620

1) The useful life is 20 years, linear method is applied.

COST in HUF million	Software acquired	Other intangi- ble assets (licenses, patents, etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties ¹⁾
Value 01.01.2015	30,420	3,491	8,682	5,763	10,905	59,263	3,146
Additions	5,076	2	806	461	744	6,374	8,513
Transfer	-	-	-	-	-	-	-
Disposals	(3,145)	(658)	(451)	(1,014)	(2,748)	(5,752)	-
Reclassification	2	-	-	32	(34)	-	-
Value 31.12.2015	32,354	2,834	9,037	5,241	8,867	59,885	11,659

DEPRECIATION AND IMPAIRMENT in HUF million	Software acquired	Other intangible assets (licenses, patents, etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties ²⁾
Value 01.01.2015	18,537	2,152	3,159	4,442	8,764	37,054	293
Additions	3,979	336	587	456	889	6,247	154
Transfer	-	-	-	-	-	-	-
Disposals	(2,300)	(692)	(199)	(891)	(2,651)	(6,734)	(13)
Reclassification	(0)	-	-	-	(0)	(1)	-
Impairment	136	-	-	-	-	136	300
Value 31.12.2015	20,351	1,796	3,547	4,006	7,002	36,703	734

NET CARRYING AMOUNT in HUF million	Software acquired	Other intangible assets (licenses, patents, etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties
Value 01.01.2015	11,884	1,339	5,523	1,321	2,141	22,208	2,854
Value 31.12.2015	12,003	1,038	5,491	1,235	1,864	21,631	10,926

1) The useful life is 20 years, linear method is applied.

2) The increase is due to a property repossessed as of 31 December 2015.

Net carrying amount

in HUF million	2015	2016
Intangible assets	13 041	18 310
Software acquired	12 003	17 513
Other intangible assets (licenses, patents, etc.)	1 038	797
Property and equipment	8 591	8 991
Own land and buildings	5 492	5 567
Office and plant equipment/other fixed assets	1 235	1 342
IT-assets (hardware)	1 864	2 082
Total intangible and tangible assets	21 631	27 301
Investment properties	10 926	10 620

Within fully amortised intangible assets still in use, Erste Hungary has recognised software with a gross value amounting to 5,764 million forint in 2016 and 9,092 million forint in 2015.

20) Tax assets and liabilities

in HUF million	Tax assets 2015	Tax assets 2016	Tax liabilities 2015	Tax liabilities 2016
Deferred taxes	122	33	874	238
Financial assets – held for trading	-	(2)	285	164
Financial assets - available for sale	-	-	874	256
Financial assets - held to maturity	-	-	(572)	(195)
Provisions	121	(2)	217	50
Other	1	37	70	(37)
Current taxes	892	1,000	13	9
Total taxes	1,014	1,033	887	247

21) Assets held for sale

in HUF million	2015	2016
Assets held for sale	26	187

‘Assets held for sale’ includes repossessed cars relating to the Erste Hungary’s leasing activity.

22) Other assets

in HUF million	2015	2016
Other clearing accounts	5,390	2,389
Receivables from sales and services	3,164	3,580
Other accrued income	1,798	2,485
Inventories	448	301
Repossessed assets ¹⁾	23,794	11,150
Prepaid expenses	3,405	4,483
Other	2,497	3,097
Total	40,496	27,486

1) Repossessed assets primarily consist of properties, and are shown at the lower of cost or net realisable value. The possession of these assets is generally taken related to loan contracts of property development projects or properties where previously served as collateral are taken over. These assets are not readily convertible into cash and Erste Hungary’s policy is to dispose of them in an orderly fashion. Erste Hungary does not occupy repossessed assets for its own business use.

The amount of the impairment of the repossessed assets is 1.3 billion forint (in 2015: 10.2 billion forint).

23) Other trading liabilities

in HUF million	2015	2016
Short positions	64	1,060
Equity instruments	64	1,060
Total	64	1,060

24) Financial liabilities**Deposits from banks**

in HUF million	2015	2016
Deposit from domestic banks	95,143	117,261
Deposit from foreign banks	331,662	96,394
of which by Austrian banks	301,571	85,752
of which subordinated liabilities	128,774	50,805
Total	426,805	213,655

Deposits from banks - subordinated liabilities

Maturity	Notional amount 2015			Notional amount 2016			Interest conditions
	in thousand EUR	in million	HUF	in thousand EUR	in million	HUF	
30 September 2021	100,000		31,312	100,000		31,102	3M EURIBOR + 3,93%, quarterly
30 September 2021 ¹⁾	63,000		19,727	-		-	3M EURIBOR + 5,34%, quarterly
30 September 2021	53,000		16,595	-		-	3M EURIBOR + 4,509%, quarterly
30 September 2021 ¹⁾	130,000		40,706	28,312		8,806	3M EURIBOR+ 4,509%, quarterly
30 June 2021	35,000		10,959	35,000		10,886	3M EURIBOR+ 4,079%, quarterly
26 March 2021 ¹⁾	30,000		9,394	-		-	3M EURIBOR+ 4,1%, quarterly
Total subordinated loans	411,000		128,693	163,312		50,793	

1) The Bank paid back a material amount of subordinated deposits during 2016, approved by NBH. Details are presented in the following table.

Maturity	Notional (in thousand EUR)	Prepayment date	Prepaid amount (in thousand EUR)	Prepaid amount (in million HUF)
30 September 2021	63,000	14 July 2016	63,000	19,760
30 September 2021	53,000	14 July 2016	53,000	16,623
30 September 2021	130,000	14 July 2016	101,688	31,894
26 March 2021	30,000	14 July 2016	30,000	9,410

Deposits from customers

in HUF million	2015	2016
Saving deposits	2,367	2,360
Other deposits	1,259,726	1,416,737
Public sector	42,615	24,363
Commercial customers	322,843	434,918
Private customers	588,258	643,756
Other financial institutions	306,010	313,700
Total	1,262,093	1,419,097

Debt securities issued

in HUF million	2015	Notional amount 2015	2016	Notional amount 2016
Bonds	23,087	19,950	15,061	10,979
of which subordinated liabilities	3,514	4,215	3,779	4,215
Mortgage bonds	-	-	47,033	46,368
Designated at fair value through profit or loss ¹⁾	-	-	24,481	23,982
Measured at amortized cost	-	-	22,552	22,386
Certificate of deposits	796	796	790	790
Total	23,883	20,746	62,884	58,137

1) As it is described in the Accounting policy, the category 'at fair value through profit or loss' is used if such classification eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases. In case Erste Hungary would not opt for valuation at fair value, the carrying amount of mortgage bonds designated at fair value through profit or loss was 24,140. By the legislation related to mortgage banks the interest rate risk is prescribed to be hedged. The risk is hedged by interest rate swaps (IRS). The original mismatch to eliminate through fair value option applied for mortgage bond issued is the different valuation base of IRS (at fair value) and mortgage bond issued (at amortised cost).

Certificates of deposit were issued by the legal predecessor of the Bank, showing a decreasing balance year by year.

issued non subordinated securities as at 31 December 2016	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Currency	Interest conditions
Bonds						
ERSTE TARTÓS KÖTVÉNY 20181116	HU0000356688	17 November 2015	16 November 2018	161	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20170217	HU0000356092	18 February 2015	17 February 2017	1,335	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180817	HU0000356522	19 August 2015	17 August 2018	599	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20171106	HU0000356340	06 May 2015	06 November 2017	1,444	HUF	zero coupon
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 14	HU0000356571	12 August 2015	11 August 2017	280	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 4.5% p.a.; payable at maturity
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 13	HU0000356274	23 March 2015	22 March 2017	622	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 5% p.a.; payable at maturity
ERSTE TARTÓS KÖTVÉNY 20171002	HU0000356241	01 April 2015	02 October 2017	2,233	HUF	zero coupon
ERSTE RAC 6.75%/2017	HU0000354139	10 February 2014	10 February 2017	1,000	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 6.75% p.a.; interest payments: yearly
ERSTE TARTÓS KÖTVÉNY 20181008	HU0000356605	07 October 2015	08 October 2018	647	HUF	zero coupon
ERSTE FIX+KAMATKÖV KÖTV. 20170703	HU0000354873	02 July 2014	03 July 2017	253	HUF	fixed in the first 6 months (coupon: 5% p.a.) then variable (linked to 6M BUBOR); payable at maturity
ERSTE FIX USD 20170908	HU0000356878	08 March 2016	08 September 2017	2	USD	fixed; coupon: 2.41% not annualized, payable at maturity
ERSTE TARTÓS KÖTVÉNY 20180102	HU0000356423	24 June 2015	02 January 2018	625	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20170113	HU0000355961	14 January 2015	13 January 2017	1,777	HUF	zero coupon
Total				10,979		
Mortgage bonds						
EJBFN21A	HU0000652920	19 October 2016	27 October 2021	12,314	HUF	fixed 2,50% interest payments: yearly
EJBFN21A	HU0000652920	19 October 2016	27 October 2021	12,000	HUF	fixed 2,50% interest payments: yearly
EJBFN19A	HU0000652912	19 October 2016	30 October 2019	11,982	HUF	fixed 2,00% interest payments: yearly
EJBFN19A	HU0000652912	19 October 2016	30 October 2019	10,071	HUF	fixed 2,00% interest payments: yearly
Total				46,368		

Debt securities issued - non-subordinated liabilities

issued non subordinated securities as at 31 December 2015	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Currency	Interest conditions
ERSTE TARTÓS KÖTVÉNY 20160115	HU0000353883	15 January 2014	15 January 2016	524	HUF	zero coupon
ERSTE RAC 6.75%/2017	HU0000354139	10 February 2014	10 February 2017	1,000	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 6.75% p.a.; interest payments: yearly
ERSTE TARTÓS KÖTVÉNY 20160423	HU0000354527	23 April 2014	23 April 2016	1,132	HUF	zero coupon
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 11	HU0000354568	23 April 2014	25 April 2016	453	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 5% p.a.; payable at maturity
ERSTE TARTÓS KÖTVÉNY 20160520	HU0000354600	21 May 2014	20 May 2016	612	HUF	zero coupon
ERSTE FIX+KAMATKÖV. KÖTV. 20170703	HU0000354873	02 July 2014	03 July 2017	253	HUF	fixed in the first 6 months (coupon: 5% p.a.) then variable (linked to 6M BUBOR); payable at maturity
ERSTE TARTÓS KÖTVÉNY 20161104	HU0000355623	05 November 2014	04 November 2016	1,172	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20161125	HU0000355771	26 November 2014	25 November 2016	781	HUF	zero coupon
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 12	HU0000356019	19 December 2014	19 December 2016	300	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 4.1% p.a.; payable at maturity
ERSTE TARTÓS KÖTVÉNY 20170113	HU0000355961	14 January 2015	13 January 2017	1,777	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20170217	HU0000356092	18 February 2015	17 February 2017	1,335	HUF	zero coupon
ERSTE FIX 20160218	HU0000356209	18 February 2015	18 February 2016	4,000	HUF	fixed; coupon: 2.47% p.a.
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 13	HU0000356274	23 March 2015	22 March 2017	622	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 5% p.a.; payable at maturity
ERSTE TARTÓS KÖTVÉNY 20171002	HU0000356241	01 April 2015	02 October 2017	2,233	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20171106	HU0000356340	06 May 2015	06 November 2017	1,444	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180102	HU0000356423	24 June 2015	02 January 2018	625	HUF	zero coupon
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 14	HU0000356571	12 August 2015	11 August 2017	280	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 4.5% p.a.; payable at maturity
ERSTE TARTÓS KÖTVÉNY 20180817	HU0000356522	19 August 2015	17 August 2018	599	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20181008	HU0000356605	07 October 2015	08 October 2018	647	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20181116	HU0000356688	17 November 2015	16 November 2018	161	HUF	zero coupon
Total				19,950		

Debt securities issued - subordinated liabilities

As of 31 December 2016

Issuer	Notional amount in HUF million	Date of issue	Maturity date	Interest conditions
Erste Bank Hungary Ltd.	389	1 December 2008	1 December 2020	fixed, interest 122.22%, payable at maturity
Erste Bank Hungary Ltd.	474	30 April 2009	30 April 2019	fixed, interest 119.7802%, payable at maturity
Erste Bank Hungary Ltd.	3,352	28 March 2014	28 March 2024	fixed, coupon: 0.9% p.a.; interest payments: yearly; issued at 49.92%
Total subordinated securities	4,215			

As of 31 December 2015

Issuer	Notional amount in HUF million	Date of issue	Maturity date	Interest conditions
Erste Bank Hungary Ltd.	389	1 December 2008	1 December 2020	fixed, interest 122.22%, payable at maturity
Erste Bank Hungary Ltd.	474	30 April 2009	30 April 2019	fixed, interest 119.7802%, payable at maturity
Erste Bank Hungary Ltd.	3,352	28 March 2014	28 March 2024	fixed, coupon: 0.9% p.a.; interest payments: yearly; issued at 49.92%
Total subordinated securities	4,215			

25) Provisions

in HUF million	2015	2016
Provision for guarantees and committed credit lines	7,261	21,664
Provision as a precaution	611	560
Provision related to loans and advances	7,871	22,225
Provision for litigations	47	86
Other provision	1,928	2,845
Sundry provision	1,975	2,931
Total	9,846	25,156

Provision as a precaution, Provision for litigations

Provision as a precaution is linked to legal cases related to lending activities. Provision for litigations covers allowances for such legal cases that have no direct linkage to the core business of the company such as, for example, labour and employment related issues.

Other provision

2015

Beside 721 million forint allocated for closed loans in scope of FX settlement, 700 million forint for FX1&2, 21 million forint for FX3 (details see in section C, page 8), 'Other provision' includes 400 million forint as the Hungarian Banking Association was fined for facilitating harmonised activities in the sector by collecting and sharing information within the member banks. The Hungarian Banking Association will charge the fine over to its member banks. Erste Hungary's share allocated as provision is based on estimative calculations. Other provision also includes a stamp duty obligation related to properties repossessed in the past, of 551 million forint.

2016

Large debt sale

The Bank concluded a mass sale in November 2016 assigning the legal title of loan receivables and certain related other receivables and rights out of the non-performing retail portfolio. Based on the Large Debt Sale and Purchase Agreement (LSPA) recourse is not allowed, but a detailed and complex claim procedure is settled.

Due to the size of the transaction and the relatively short time frame to proceed, the risk of potential claims by the buyer could not be eliminated. The contractual claim procedure is similar in substance to warranties, so the Bank allocated a provision, conforming the liability cap prescribed in LSPA, of 1.78 billion forint.

By the LSPA the Bank sold about 9,137 pieces of contract, in the gross amount of 31.6 billion forint and net amount of 18.2 billion forint.

In addition to 'Large debt sale' provision, 'Other provision' also includes a stamp duty obligation related to properties repossessed in the past of 551 million forint and 160 million forint provision for closed loans in scope of FX settlement / FX1&2 (details see in section C, page 8).

in HUF million	01.01.2016	Allocations	Use	Releases	Reclassification	Exchange rate changes	31.12.2016
Provision for guarantees	7,260	15,238	-	(981)	-	146	21,664
Provision as a precaution	611	166	(3)	(208)	(1)	(4)	560
Other sundry provisions	1,975	5,381	(3,691)	(734)	1	-	2,931
Total	9,846	20,785	(3,694)	(1,924)	-	142	25,156

in HUF million	01.01.2015	Allocations	Use	Releases	Reclassification	Exchange rate changes	31.12.2015
Provision for guarantees	1,356	9,182	-	(3,272)	-	(6)	7,260
Provision as a precaution	377	269	(0)	(72)	15	23	611
Other sundry provisions	21,306	5,824	(24,893)	(249)	(15)	1	1,975
Total	23,039	15,276	(24,893)	(3,594)	-	18	9,846

26) Other liabilities

in HUF million	2015 reclassified	2016
Deferred income ¹⁾	1,197	4,791
Clearing accounts	8,051	13,553
Tax liabilities	186	-
Payment accounts from sales and services	1,307	2,149
Received payments on advance	785	1,001
Accruals of other expenses	7,728	10,125
Other liabilities	815	811
Total	20,069	32,429

1) Increase in Deferred income is due to government grant recognition.

Erste Hungary recognises government grant related to the following:

- National Bank of Hungary (NBH) security program
NBH introduced a floating-rate-payer forint interest rate swap (IRS) facility with terms of three and five years starting from June 2014 and one with a term of ten years starting from July 2015. This facility applies some preferential elements to intensify usage of IRS tenders and also additional purchase of government securities by Banks. Banks are entitled to the preferential element if the government security portfolio is kept at a given level. In 2016 240 million forint is presented as government grant related to IRS, the deferred income is 1,551 million forint.
- NBH SME lending program (PHP)
NBH introduced a lending activity linked floating-rate-payer forint interest rate swap (HIRS) with terms of one and three years starting from February 2016. Banks are entitled to the preferential gain if criteria combining growth and stability elements related to lending activity in SME sector are met. In 2016 1,417 million forint is presented as government grant related to HIRS, the deferred income is 3,240 million forint.

Government grant is presented starting from 2016:

At 1 January 2016	824 million forint
Received during the year	4,657 million forint
Released to the income statement	1,657 million forint
At 31 December 2016	3,824 million forint

2015 data are subject of reclassification, see in Note 9, page 34:

At 1 January 2015	- million forint
Received during the year	351 million forint
Released to the income statement	37 million forint
At 31 December 2015	314 million forint

27) Total equity

in HUF million	2015	2016
Subscribed capital	102,000	146,000
Additional paid-in capital	83,493	117,492
Retained earnings and other reserves	(25,225)	17,523
Total	160,268	281,015
Attributable to non-controlling interests	-	-
Attributable to owners of the parent	160,268	281,015

Subscribed capital and Additional paid-in capital

In 2015 the Bank decided to offset the negative retained earnings by the Hungarian Accounting Standard from the additional paid-in capital. The Hungarian accounting law contains this possibility listing in a laxative way the decreasing and increasing events of the capital elements (law C of 2015, paragraph 36-37). 199,834 billion forint was transferred in that frame from additional paid-in capital into retained earnings.

As 31 December 2015 subscribed capital amounted to 102,000,000,000 forint (in words: one hundred and two billion). The subscribed capital consisted of 102,000,000,000 (in words: one hundred and two billion) pieces of dematerialized ordinary shares of 1 forint nominal value each.

In 2016 Erste Group Bank AG decided to increase the Bank's subscribed capital by way of a capital increase based on the issuance of new shares by 44,000,000,000 forints (in words: forty four billion) from 102,000,000,000 forints (in words: one hundred and two billion) to 146,000,000,000 forints (in words: one hundred and forty six billion). 44,000,000,000 registered, dematerialized ordinary shares of 1 forint nominal value each, each having the rights as set down in the Company's Statutes were issued. Additional paid-in capital relating to the issuance of the new shares amounts to 33,998,800,000 forints.

Owners of the Bank

As of 31 December 2016, the direct parent of the Bank – owning 70% of the shares – was Erste Group Bank AG, whose registered office at that date was Am Belvedere 1, 1100 Vienna, Austria. The Consolidated Financial Statements of Erste Group are prepared by the ultimate parent of Erste Group 'Erste Group Bank AG', and are available after their completion at the Court of Registry of Vienna, Marxergasse 1a, 1030 Vienna, Austria.

Corvinus Nemzetközi Befektetési Zrt. [Corvinus International Investment Private Limited Company] (on behalf of the Government of Hungary) and the European Bank for Reconstruction and Development (EBRD) entered into share purchase agreements with Erste Group Bank AG in respect of each acquiring a 15 per cent shareholding in Erste Bank Hungary Zrt. The purchase price is 77.78 billion forint in total. The details of the transaction were laid down in general agreements signed by the parties on 20 June 2016. Following the approvals of the competent authorities and meeting other conditions set out in the agreements, the actual transfer of ownership rights took place on 11 August 2016.

The share purchase was approved by the National Bank of Hungary on August 4, 2016 (H-EN-I-693/2016), and the change in the ownership was registered in the company register on August 24, 2016.

Owner	31 December 2015		31 December 2016	
	Number of shares	Ownership share	Number of shares	Ownership share
Erste Group Bank AG	102,200,000,000	100%	102,200,000,000	70%
Corvinus Nemzetközi Befektetési Zrt.	-	-	21,900,000,000	15%
European Bank for Reconstruction and Development	-	-	21,900,000,000	15%
Total	146,000,000,000	100%	146,000,000,000	100%

Retained earnings and other reserves

Within 'Retained earnings and other reserves' the Bank records a 'General Reserve'. Section 83 of the Credit Institutions and Financial Enterprises Act obliges the Bank to allocate 'General Reserve' amounting to 10% of the actual year's profit after tax, as a non-distributable income. Any use of the reserve needs to be in connection to losses on the Bank's core activity. In 2016 the Bank allocated 3,526 million forint general reserve.

28) Segment reporting

The segment reporting of Erste Hungary follows the presentation and measurement requirements of IFRS. For management purposes, the bank is organised into nine operating segments based on products and services and into one technical segment, as follows

Retail

The Retail segment is constituted by the branch network where Erste Hungary sells products mainly to private and micro customers (up to 0.7 million euro GDP weighted turnover). The Retail business line at Erste Hungary is divided into 7 regions and 123 branches in 2016 (9 regions and 128 branches in 2015).

The relevant results of the leasing company (Erste Lakáslízing Zrt), building society (Erste Lakás-takarékpénztár Zrt.) and investment banking and brokerage company (Erste Befektetési Zrt) are also included into this segment, along with the relevant results of three workout companies (Collat-real Kft., Erste Ingatlan Kft. and Erste In-forg Kft.).

SME

SME includes business with small and medium sized enterprises clients which are under the responsibility of the local corporate commercial center network, mainly consisting of companies with an annual turnover from EUR 0.7 million to EUR 25 million.

The relevant results of workout / property management companies (Erste Ingatlan Kft. and Sió Ingatlan Invest Kft.) are also included into this segment

Local Large Corporates (LLC)

Local Large Corporates (LLC) are clients with a consolidated annual turnover threshold above EUR 25 million to EUR 500 million which are not defined as Group Large Corporate customers according to the Group Large Corporate client list.

Group Large Corporates (GLC)

Group Large Corporates (GLC) are large corporate customers/ client groups with substantial operations in core markets/extended core markets of Erste Group with an indicative consolidated annual turnover of at least EUR 500 million. GLC clients can be found on the Group-wide GLC client list, which is maintained by the Group GLC. Group Large Corporates business covers the following customer types in principle: customers across the region with an annual turnover above EUR 500 million, selected customers with an annual turnover below EUR 500 million in case of multinational setup or strong capital markets service needs, listed and to be listed sovereign owned corporates, financial sponsors (e.g. Private Equity Funds), the participations (in case of majority stake) of the financial sponsors will be grouped together with the financial sponsor, therefore treated within GLC. International groups headquartered outside the extended core market and which have an annual consolidated turnover above EUR 500 million are segmented as GLC client only if Erste Group has a relationship with the international groups' headquarter.

Public Sector (PS)

Public Sector consists of the following three sets of customers: public sector, public corporations and non-profit sector.

Public sector includes such customers as central ministries and state funded funds and agencies, non-profit entities established by or under control of central government entities, regional governments and organizations funded by them, state capitals, public health and social insurance companies. In general Public sector excludes banks and non-bank financial institutions (FI), pension funds, bond issuing agencies (incl. government debt agencies), asset management based organizations which are part of the Group Markets segment.

Public corporations includes all non-financial state companies and corporations with more than 50% share of state or regional governments or municipals excluding stock exchange listed companies.

Non-profit sector comprises the following private non-profit companies: central authorities of churches, country-wide labour unions, political parties and nationally significant foundations, private schools and humanitarian organizations.

Commercial Real Estates (Commercial RE)

Commercial Real Estates business covers investors in real estate for the purpose of generating income from the rental of individual properties or portfolios of properties, developers of individual properties or portfolios of properties for the purpose of generating capital gains through sale, asset management services. The Commercial Real Estates segment consists of the Erste Hungary Real Estate Business Line and the workout company's relevant results (Erste Ingatlan Kft.).

Group Markets (GM)

Group Markets (GM) segment comprises trading and markets services as well as business with financial institutions. Trading and Market services comprises all activities related to active risk taking and managing in regulatory trading books of Erste Group, additional to that the execution of trades against the market using the trading books of Erste Group for market making, short-term liquidity management and warehousing purposes. Specifically revenues and fair value results not directly attributable to client transactions (which can be valid also for ALM deals) and generally risk premiums and execution fees are taken into account. It also includes 20% compensation fee from Retail for the treasury sales services.

Financial institutions (FI) are companies that provide financial services for their clients or members and act as professional and active participant on financial markets for the purpose of proprietary trading or on behalf of their clients (banks, central banks, development

banks, investment banks, investment funds, brokerages, insurance companies, pension funds, credit unions, building societies, asset management companies, government debt agencies, sovereign wealth funds, exchanges).

Business connected with serving financial institutions as a client including custody, depository services, commercial business (loans, cash management, trade & export finance) and capital markets business falls under FI.

Besides the Bank's own activities, it also includes institutional clients (typically funds, and asset management companies) at the brokerage company (Erste Befektetési Zrt.)

Asset and Liability Management (ALM)

The Business line ALM segment comprises the management of bank assets and liabilities in the light of uncertainty of cash flows, cost of funds and return on investments in order to determine the optimal trade-off between risk, return and liquidity. Furthermore it comprises funding transactions, hedging activities, investments into securities other than held for trading purpose, management of own issues and FX positions.

Dealing with these risks means managing the structure of the statement of financial position (banking book) according to market conditions in order to cover the bank's liquidity needs and to ensure a high degree of capital utilisation. ALM also contains the transformation margin as a result of mismatch in the statement of financial position from both a time and currency point of view. The transformation margins as well as ALM's own business (HtM, AfS portfolio assets and bonds issued liabilities) comprise the main part of this segment.

The full results of mortgage/refinancing bank company (Erste Jelzálogbank Zrt.) is also included in this segment.

Corporate Centre (CC)

The Corporate Centre contains all non-core banking business activities such as non-profit servicing participations (e.g. IT, Procurement, Facility Management), intragroup eliminations within the respective partial group, dividends, refinancing costs of participations, all non-banking balance sheet positions (e.g. fixed assets, intangible assets) which cannot be allocated to other business segments as well as the profit and loss positions resulting from these balance sheet items. Apart from that the Corporate Center includes the reconciliations to the accounting result. Non-allocated subsidiaries like property management companies' Corporate Centre (Erste Ingatlan Kft., Sió Ingatlan Invest Kft., Erste In-forg Kft, Collat-Real Kft.) are also recorded in this segment.

Free Capital (FCAP)

Free capital is not a segment but instead shows the difference between the total equity according to the statement of financial position and the sum of the allocated capital of segments.

Transactions between operating segments are on an arm's length basis.

Segmentation by core business Segment reporting 2016

in HUF million	FCAP	RETAIL	SME	LLC	GLC	PS	Commercial RE	GMT	GMFI	ALM	CC	TOTAL
Net interest income	2,797	42,700	7,429	1,189	1,114	1,096	3,603	2,360	3,554	(6,384)	(2,660)	56,796
Net fee and commission income	-	33,443	5,269	517	349	461	258	2,359	1,761	(86)	(170)	44,161
Dividend income	-	-	-	-	-	-	-	-	-	-	28	28
Net trading and fair value result	-	2,108	1,695	173	100	20	772	2,983	969	(3,537)	1,455	6,738
Net result from equity method investments	-	-	-	-	-	-	-	-	-	-	-	-
Rental income from investment properties & other operating leases	-	-	322	-	-	-	914	-	-	-	-	1,236
General administrative expenses ¹	-	(48,068)	(6,348)	(823)	(494)	(514)	(1,839)	(2,122)	(1,102)	(533)	937	(60,905)
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	-	-	-	-	-	-	-	(60)	101	(1,180)	4,030	2,890
Net impairment loss on financial assets not measured at fair value through profit or loss	-	18,718	(1,939)	399	(210)	3,029	8,833	(3)	9	(1)	(34,133)	(5,297)
Other operating result	-	(11,013)	(1,647)	(106)	(356)	(119)	(12,669)	177	(364)	(17)	27,886	1,772
thereof: Levies on banking activities	-	(8,102)	(2,917)	(328)	(211)	(214)	(101)	(0)	(406)	-	(6,124)	(18,403)
Pre-tax result from continuing operations	2,797	37,888	4,780	1,349	503	3,973	(127)	5,694	4,927	(11,738)	(2,626)	47,420
Taxes on income	(1,142)	(9,255)	(1,277)	(299)	(131)	(791)	(316)	(1,109)	(1,075)	5	11,314	(4,077)
Net result for the period	1,654	28,633	3,504	1,049	371	3,182	(443)	4,585	3,853	(11,733)	8,688	43,343
Net result attributable to non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	-
Net result attributable to owners of the parent	1,654	28,633	3,504	1,049	371	3,182	(443)	4,585	3,853	(11,733)	8,688	43,343
												-
Total assets	-	760,297	133,537	32,429	45,794	12,436	177,628	279,768	88,434	643,832	(127,275)	2,046,881
Total liabilities	-	715,168	269,500	45,382	49,957	31,111	73,044	63,928	410,212	294,968	(187,406)	1,765,865

1) General administrative expenses consist of personnel expenses, other administrative expenses, and depreciation and amortisation

Segment reporting 2015 - resegmented

in HUF million	FCAP	RETAIL	SME	LLC	GLC	PS	Commercial RE	GMT	GMFI	ALM	CC	TOTAL
Net interest income	505	57,870	7,675	1,445	672	914	3,149	5,027	1,842	(11,769)	(5,326)	62,003
Net fee and commission income	-	31,753	4,993	517	386	645	231	2,052	1,846	(12)	180	42,591
Dividend income	-	-	-	-	-	-	-	-	-	-	55	55
Net trading and fair value result	-	1,023	1,363	222	81	14	415	111	775	(1,507)	(2,644)	(147)
Net result from equity method investments	-	-	-	-	-	-	-	-	-	-	-	-
Rental income from investment properties & other operating leases	-	-	273	-	-	-	-	-	-	-	-	273
General administrative expenses ¹	-	(43,671)	(6,149)	(948)	(270)	(664)	(1,924)	(1,866)	(882)	(260)	899	(55,735)
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	-	-	-	-	-	12	-	(10)	-	(1,459)	-	(1,456)
Net impairment loss on financial assets not measured at fair value through profit or loss	-	(35,331)	(669)	181	(28)	57	3,028	(10)	(13)	-	(9,022)	(41,807)
Other operating result	-	(8,472)	(2,958)	(482)	(224)	(1,088)	(3,992)	(5)	(469)	(28)	(6,628)	(24,346)
thereof: Levies on banking activities	-	(8,290)	(2,724)	(349)	(189)	(213)	(88)	4	(449)	-	(14,652)	(26,950)
Pre-tax result from continuing operations	505	3,171	4,528	935	616	(109)	907	5,300	3,099	(15,035)	(22,488)	(18,571)
Taxes on income	(173)	(3,415)	(1,483)	(267)	(168)	(50)	(371)	(1,214)	(684)	-	4,384	(3,440)
Net result for the period	332	(244)	3,045	669	448	(159)	536	4,086	2,416	(15,035)	(18,104)	(22,010)
Net result attributable to non-controlling interests	-	-	-	-	-	-	-	-	-	-	-	-
Net result attributable to owners of the parent	332	(244)	3,045	669	448	(159)	536	4,086	2,416	(15,035)	(18,104)	(22,010)
												-
Total assets	-	763,475	113,242	30,640	16,776	26,003	158,478	308,085	52,950	428,057	26,512	1,924,219
Total liabilities	-	641,165	214,097	37,046	11,884	30,946	25,828	166,439	373,204	301,264	(37,921)	1,763,951

1) General administrative expenses consist of personnel expenses, depreciation and amortization, and other administrative expenses

Geographical segmentation is not applied as Hungary is in the focus of Erste Hungary's business activity (above 95% of the revenues are realised domestic).

Resegmentation

2015 year end resegmentation between Business Lines are triggered by the following items:

- I. Segments mainly involved in resegmentation are Corporates (SME, Real Estate, Large Corporate, OTGCIB according to old segmentation):
 - a. triggered by client movements (portfolio shift between Business Lines) based on new segment definitions according to new Group Segment Reporting Policy; Total portfolio on individual client basis was reviewed and re-segmented.

Main drivers:

 - i. Municipality portfolio was entirely shifted from SME to Public Sector;
 - ii. Investment funds and Real Estate investment funds were shifted from SME and Real Estate to GM Financial Institutions (GMFI) according to new segmentation;
 - iii. Earlier Large Corporate segment is splitted to GLC (Group Large Corporate) and LLC (Local Large Corporate)
 - b. cancellation of OTGCIB BL (Erste Investment Bank's (EIH) Other GCIB) and shift to GMFI

- II. Group Markets (earlier GM Trading, GM Sales and GM Overlaps)
- Cancellation of GM Sales and GM Overlaps, and therewith GM sales revenues are to be allocated 100% to Business Segments (Retail, SME etc.)
 - GM Financial Institutions is newly created
 - EIH GM Trading increased due to cancellation of GM Sales and GM Overlaps in terms of AuM business and shifted partially to EIH GM Trading and therewith having 80% - 20% revenue split between Bank Retail and EIH GM Trading.
 - Volume (especially deposits) and revenue reallocation from Corporates to GMFI.
- Capital allocation changes are reflected in all segments (including non-client businesses).
 - Pillar 2 RWA * 9,5% (earlier it was calculated with 8,0%) in line with CET1 target rate increase defined by Erste Group; allocated equity changes are also effected by change in Operational Risk, its volume is triggered by reallocation of General Administrative Expenses.
 - Change in Cost of Capital calculation are reflected in all segments as well: the risk free rate (i.e. 5Y MA of the 5Y interest rate) and the shareholders' risk premium, which is determined as 10.5% (earlier it was 8% and changed in line with ROE target increase by Group).

29) Assets and liabilities denominated in foreign currencies

Assets and liabilities not denominated in forint were as follows:

in HUF million	of which outside Hungary			
	2015	2016	2015	2016
Assets	266,590	333,098	57,406	54,919
EUR	186,291	258,303	18,253	21,355
CHF	50,347	20,487	12,192	77
USD	22,264	51,021	19,774	30,696
JPY	880	798	566	545
Other	6,808	2,489	6,620	2,246
Liabilities	417,699	595,365	171,912	72,937
EUR	346,145	505,978	160,261	65,312
CHF	27,480	29,741	8,496	5,452
USD	35,376	50,266	2,497	1,604
JPY	1,638	1,273	342	213
Other	7,060	8,106	316	355

30) Leases

The determination of whether an arrangement is a lease or it 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) Finance leases

Erste Hungary as a lessor leases both movable property and real estate to other parties under finance lease arrangements. For the finance lease receivables included in this item, the reconciliation of the gross investment in leases to the present value of the minimum lease payments is as follows:

in HUF million	2015	2016
Outstanding minimum lease payments	29,581	33,313
Non-guaranteed residual values	12,640	14,140
Gross investment	42,221	47,713
Unrealised financial income	6,110	5,529
Net investment	36,110	42,184
Present value of non-guaranteed residual values	12,640	14,400
Present value of minimum lease payments	23,470	27,784
Risk provision related to outstanding minimum lease payments	(2,045)	(1,880)

The maturity analysis of gross investment in leases and present values of minimum lease payments under leases is as follows (residual maturities):

in HUF million	Gross investment		Present value of minimum lease payments	
	2015	2016	2015	2016
< 1 year	5,545	7,336	4,560	6,343
1-5 years	17,180	27,710	11,679	15,125
> 5 years	19,496	18,667	7,231	6,316
Total	42,221	47,713	23,470	27,784

b) Operating leases

Future minimum lease payments under non-cancellable operating leases as at 31 December are, as follows:
Erste Hungary as lessor has no operative leasing activity.

Future minimum lease payments under non-cancellable operating leases as at 31 December are, as follows:

Erste Hungary as lessee:			
in HUF million	2015 restated	2016	
< 1 year	3,946	3,826	
1-5 years	11,515	10,239	
> 5 years	1,705	7,568	
Total	17,166	21,632	

Operating leases where Erste Hungary is the lessee comprises the leasing expenses of office space, branches and multifunctional IT devices as included within 'General administrative expenses'. There is a contractual prolongation option, 5 years for headquarter office, 1-5 years for branches.

31) Related party transactions

Besides the principal shareholder, Erste Hungary also defines other entities and associates which are members of Erste Group as related parties. Furthermore related parties consist of Management and Supervisory Board Members as well as companies over which these persons have control or significant influence. Transactions between the Bank and its fully consolidated companies are eliminated in the consolidated financial statements. Transactions with related parties are undertaken on an arm's length basis.

The following terms are used in the below table:

Parent:	being the ultimate parent 'Erste Group Bank AG' for all two periods presented
Fellow subsidiaries:	all companies consolidated by Erste Group except for subsidiaries of Erste Hungary's that are eliminated through consolidation.
Minority owners:	In 2016 Corvinus Nemzetközi Befektetési Zrt. [Corvinus International Investment Private Limited Company] (on behalf of the Government of Hungary) and the European Bank for Reconstruction and Development (EBRD) entered into share purchase agreements with Erste Group Bank AG in respect of each acquiring a 15 per cent shareholding in Erste Bank Hungary Zrt.

Loans and advances and amounts owed to related parties

in HUF million	2015	2016
Loans and advances to credit institutions	31,618	38,300
Parent	31,616	38,288
Fellow subsidiaries	2	12
Loans and advances to customers	23,979	22,853
Fellow subsidiaries	23,979	22,853
Derivative financial instruments - asset	3,383	8,830
Parent	1,705	7,370
Fellow subsidiaries	1,678	1,460
Other assets	3,049	3,325
Parent	2,882	3,168
Fellow subsidiaries	167	137
Deposits by banks	302,353	35,714
Parent	301,593	34,949
Fellow subsidiaries	760	765
Customer deposits	4,199	17,856
Fellow subsidiaries	4,199	17,856
Derivative financial instruments - liabilities	18,325	6,793
Parent	18,325	6,793
Other liabilities	1,677	1,563
Parent	382	266
Fellow subsidiaries	1,295	1,297
Subordinated liabilities	128,774	50,793
Parent	128,774	50,793

Income and expenses to related parties

in HUF million	2015	2016
Interest Income	3,231	1,716
Parent	2,823	1,418
Fellow subsidiaries	408	298
Interest Expense	(10,552)	(6,219)
Parent	(10,546)	(6,215)
Fellow subsidiaries	(7)	(4)
Minority owners	0	(20)
Fee and commission income	1,114	1,196
Parent	389	538
Fellow subsidiaries	725	658
Fee and commission expense	(289)	(216)
Parent	(72)	(60)
Fellow subsidiaries	(217)	(156)
Other Income/(Expense)	137	216
Parent	132	78
Fellow subsidiaries	5	138

Related party transactions to Management and Supervisory Board Members and Board of Directors**Management compensation**

in HUF million	2015	2016
Fixed salary	285	371
Performance related compensation	112	265
Other compensation	54	58
Total	451	694

The members of the Management Board (the internal members of the Board of Directors) do not receive any additional compensation for their board memberships. The compensation of management board members is based on the individual's responsibilities, the achievement of corporate targets and the group's financial situation.

The above includes employment related compensation only, severance payments are not included.

‘Other compensation’ includes other contractual allowances.

Contractual and outstanding amounts of loans granted to Board of Directors and Supervisory Board are 65.6 and 65.13 million forint in 2016 and 13.4 and 8 million forint in 2015, respectively.

In the year under review, management board members that held office in 2016 received remuneration (*including employment related compensation only; severance payments are not included*) totalling 694 million forint (in 2015: 451 million forint). 2016 performance related payments are not yet allocated, only budget is available.

From 2011, in accordance with Erste Hungary’s Remuneration Policy – which is based on CRDIV by EU (Capital Requirements Directive IV) on remuneration policies and the Hungarian Banking Act - management board members are recognized as identified staff and the following special rules are applied for their performance related compensation:

- The performance related compensation is based both on Erste Hungary financial results and individual performance. The bonus amount is defined by qualitative and quantitative key performance indicators (KPIs) agreed by Erste Group HR and Erste Group Performance Management. Applied KPIs are risk adjusted financial result indicators, business specific objectives and leadership competencies.
- 60% of the performance related compensation is granted as upfront payment and 40% is deferred for 3 years in equal instalments. Deferred amounts are subjects to re-evaluation and might be decreased based on its result.
- 50% of both upfront and deferred payments have to be non-cash instruments. Erste Hungary chooses the phantom stock plan of Erste Group as a non-cash instrument. Non-cash instruments have to be held for a retention period of 1 year.

These rules are effective from the 2011 performance year.

Breakdown of Supervisory Board and Board of Directors compensation:

in HUF million	2015	2016
Supervisory Board compensation	8	23
Board of Directors compensation	458	705
Total	465	728

Supervisory Board compensation includes only the remuneration received for the duties in the supervisory body; severance payments are not included.

The remuneration of the internal members of the Board of Directors includes employment related compensation only received by in their functional positions. They are not paid any additional compensation for their board memberships.

The Supervisory Board of the Bank is set-up of three local employee members and five external members who do not have any functional responsibility within the company. In 2016 the external members of the Supervisory Board received a compensation of 23 million forint per year for the membership (in 2015 7.7 million forint).

The Board of Directors of the Bank is set-up of the members of the managerial board and five external members who do not have managerial responsibility within the company. The external members received a compensation of 12 million forint per year in 2016 (in 2015 7.1 million forint).

Organization of Erste Bank Hungary Zrt.

- (i) the General Meeting;
- (ii) the Board of Directors;
- (iii) the Supervisory Board;
- (iv) the Audit Committee (as sub-committee of the Supervisory Board);
- (v) the Remuneration and Nomination Committee ;
- (vi) the Risk Governance Committee and
- (vii) the Managing Board.

The General Meeting is the supreme body of the Bank. The General Meeting shall be called by the Board of Directors as soon as reasonably practicable upon the written request of one or more Shareholders or by any Supervisory Board member. In the cases set out in the applicable laws, the competent authority, the Auditor, and the court of registration may also initiate the decision-making of the General Meeting.

Members of the Board of Directors

The Board of Directors is the managing body of the Bank, which directs the operation, as well as the management of the Bank within the framework of the laws, the Statutes, and the resolutions passed by the General Meeting of the Bank, as well as with taking into consideration the recommendations made by the Supervisory Board.

The Board of Directors consists of 3 (three) members at the minimum. The members of the Board of Directors shall be elected by the General Meeting for a maximum of 5 (five) years. The members of the Board of Directors may be re-appointed and recalled at any time by the General Meeting. Such persons may be elected as members of the Board of Directors who comply with the conditions set out in the Civil Code, the Banking Act, other laws and Erste Bank Hungary Zrt.'s Statutes.

Members of the Supervisory Board

The Supervisory Board consists of a minimum of 3 (three) and a maximum of 9 (nine) members who are elected by the General Meeting for a maximum of 5 (five) years. The members of the Supervisory Board may be re-elected and recalled by the General Meeting.

The members of the Supervisory Board may be executive officers and Supervisory Board members in other business organizations pursuing – among others – the same activity as the Bank. If such business organization pursuing (among others) the same activity is not a member of Erste Group, the approval of the General Meeting is necessary for holding such position in the other business organisation.

The General Meeting shall elect the chairman of the Supervisory Board from its members.

The Chairman of the Supervisory Board may be invited to the meetings of the Board of Directors with consultation rights.

Members of the Remuneration and Nomination Committee

The members of the Committee shall be 3 (three) delegated person from the external members of the Board of Directors.

The chairman of the Committee is elected by the Committee itself from the members of the Committee.

Members of the Risk Governance Committee

The members of the Committee shall be 3 (three) delegated person from the external members of the Board of Directors.

The Risk Governance Committee elects the chairman of the Committee from among the members of the Committee.

Members of the Managing Board

The Managing Board (the "Managing Board") is a body that exercises operative control over the Bank, makes the necessary decisions and specifies principles to manage the daily operation of the Bank and shall be established by the Board of Directors, within its own organisation. Members of the Managing Board are the Chairman of the Board of Directors, the Chief Executive Officer of the Bank and each deputy CEO if such person is a member of the Board of Directors.

32) Collateral

The following assets were pledged as security for liabilities:

in HUF million	2015	2016
Loans and receivables to credit institutions and customers	70,072	99,446
Financial assets - held for trading	12,309	2,489
Financial assets - available for sale	36,424	36,247
Financial assets - held to maturity	86,081	61,659
Total	204,886	199,841

The financial assets pledged as collateral consist of loan receivables, bonds and other interest-bearing securities.

Collaterals were pledged as a result of repo, refinancing, derivative and card transactions.

Loans and receivables to customers contain SME loans for a refinancing program with the National bank of Hungary, of 16,254 million forint (30,624 million forint in 2015). Details of the program see in Note 9, Other operating result table, comment 2), page 34.

This category also contains encumbered deposits placed for derivative and card transactions.

33) Securities lending and repurchase transactions

in HUF million	2015		2016	
	Carrying amount of transferred assets	Carrying amount of associated liabilities	Carrying amount of transferred assets	Carrying amount of associated liabilities
Securities lending	249	-	1,652	-
Financial assets - held for trading	249	-	1,652	-
Repurchase agreements	26,039	37,228	-	-
Financial assets - held for trading	11,605	22,783	-	-
Financial assets - available for sale	5,686	5,688	-	-
Financial assets - held to maturity	8,748	8,757	-	-
Total	26,288	37,228	1,652	-

in HUF million	2015			2016		
	Fair value of transferred assets	Fair value of associated liabilities	Net position	Fair value of transferred assets	Fair value of associated liabilities	Net position
Securities lending	249	-	249	1,652	-	1,652
Financial assets - held for trading	249	-	249	1,652	-	1,652
Repurchase agreements	25,802	37,228	(11,426)	-	-	-
Financial assets - held for trading	11,605	22,783	(11,178)	-	-	-
Financial assets - available for sale	5,688	5,688	(0)	-	-	-
Financial assets - held to maturity	8,509	8,757	(248)	-	-	-
Total	26,051	37,228	(11,177)	-	-	-

Assets received and transferred by Erste Hungary under sale and repurchase agreements largely consist of securities.

34) Off-setting

Financial assets subject to offsetting and potential offsetting agreements in 2016

in HUF million	Gross amounts in Statement of Financial Position	Amounts set off against financial liabilities	Net amounts in Statement of Financial Position	Potential effects of netting agreements not qualifying for offsetting in Statement of Financial Position			Net amount after potential offsetting
				Financial instruments	Cash collateral received	Non-cash financial collateral received	
Derivatives	15,397	-	15,397	6,802	-	-	8,594
Reverse repurchase agreements	9,809	-	9,809	-	-	9,803	6
Total	25,206	-	25,206	6,802	-	9,803	8,600

Liabilities subject to offsetting and potential offsetting agreements 2016

in HUF million	Gross amounts in Statement of Financial Position	Amounts off against financial assets	Net amounts in Statement of Financial Position	Potential effects of netting agreements not qualifying for offsetting in Statement of Financial Position			Net amount after potential offsetting
				Financial instruments	Cash collateral pledged	Non-cash financial collateral pledged	
Derivatives	11,337	-	11,337	6,802	-	-	4,535
Repurchase agreements	-	-	-	-	-	-	-
Total	11,337	-	11,337	6,802	-	-	4,535

Financial assets subject to offsetting and potential offsetting agreements in 2015

in HUF million	Gross amounts in Statement of Financial Position	Amounts set off against financial liabilities	Net amounts in Statement of Financial Position	Potential effects of netting agreements not qualifying for offsetting in Statement of Financial Position			Net amount after potential offsetting
				Financial instruments	Cash collateral received	Non-cash financial collateral received	
Derivatives	22,019	-	22,019	1,758	-	10,987	9,274
Reverse repurchase agreements	2,995	-	2,995	-	-	2,994	1
Total	25,014	-	25,014	1,758	-	13,981	9,275

Liabilities subject to offsetting and potential offsetting agreements 2015

in HUF million	Gross amounts in Statement of Financial Position	Amounts off against financial assets	Net amounts in Statement of Financial Position	Potential effects of netting agreements not qualifying for offsetting in Statement of Financial Position			Net amount after potential offsetting
				Financial instruments	Cash collateral pledged	Non-cash financial collateral pledged	
Derivatives	20,566	-	20,566	1,758	-	-	18,808
Repurchase agreements	37,228	-	37,228	-	-	36,790	439
Total	57,794	-	57,794	1,758	-	36,790	19,246

35) Risk management

35.1. Risk Management Principles

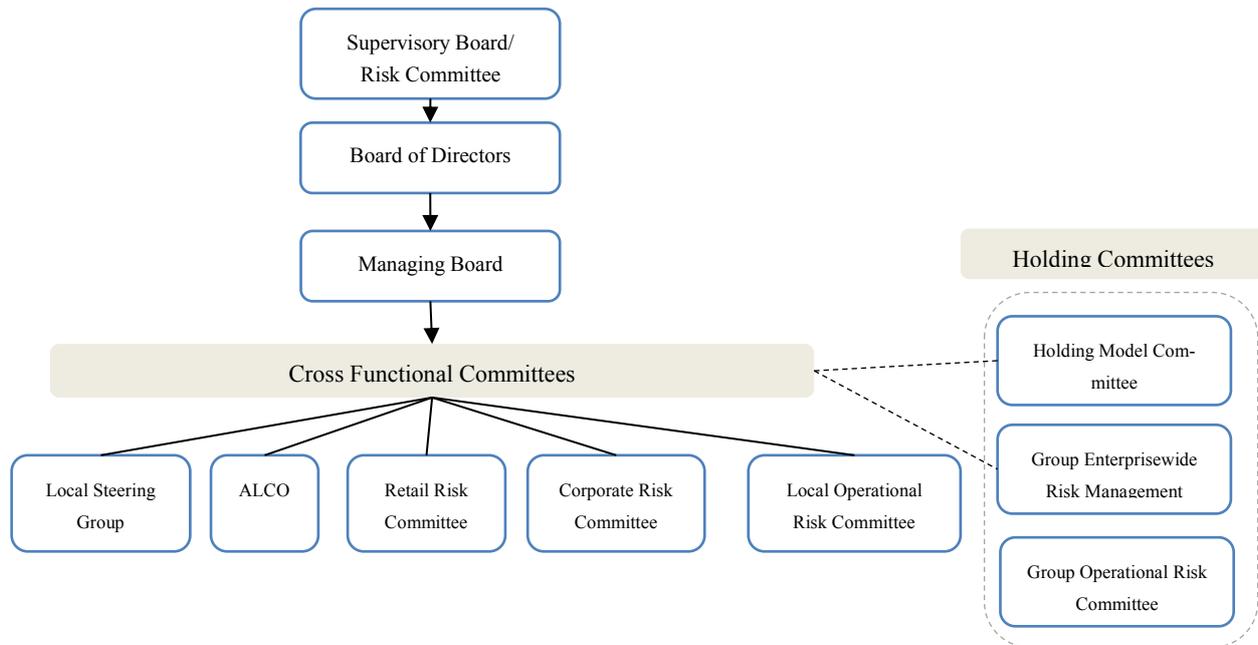
Erste Hungary naturally takes risk in connection with its business and as such following principles underpin risk management in the institution:

- Erste Hungary's chief risk officer ("CRO") is accountable for developing the Risk Strategy Framework and ensures that the components of the Framework are well defined. Risk Strategy Framework is signed off by Managing Board, Board of Directors while Supervisory Board's Risk Committee ensures control over the Risk Strategy Framework (i.e. key principles, compliance to the group strategy, and regularly reviews the status on the individual components).
- Risk Appetite Statement as one of the cornerstones of Risk Strategy Framework is set in conjunction with the business and capital/liquidity strategy covers mid-term horizon (usually 3 years' timeframe). Risk Appetite Statement is valid until withdrawn, and reviewed once a year prior to planning process, validated during the planning process, signed off by the management together with the final business plan.
- Enterprise Risk Management ("ERM") Framework provides the processes, controls, and toolkits to carry out regular review of internal capital adequacy assessment, including the regular RAS monitoring process.
- CRO is accountable for aggregating the risks that Erste Hungary is exposed to, to manage effective reporting systems and overall to deliver and submit a holistic view on all risks types to the management. Timely and transparent reporting system must be established with continuous assessment of risks and exceptional cases shall be reported immediately.
- Monitoring and back-testing over operation of risk management methodologies and models must be ensured. This means to have a regular structured assessment process, which validates accuracy and relevancy of the models, reviews the implemented processes of use.
- The detailed provisions and requirements necessary to comply with the Risk Strategy Framework shall be described in lower level risk policies, guidelines and operational working instruction according to the structure of Risk Policy Framework for all risk types arising from the risk taking activities.
- Roles and responsibilities were separated in line with the "three lines of defence model" and shall be clearly defined within the organization. That is business units within the Bank (i.e. units taking risk) and risk management units (i.e. units assessing, controlling and monitoring the risk) shall be separated from each other organizationally and in terms of the responsibilities up to the level of Managing Board. Respective risk management activities shall be audited and evaluated by the independently functioning Internal Audit, and should be overseen and verified by the Supervisory Board.
- Erste Hungary ensured risk mitigation action and an adequate capital level which shall cover minimum level of risks planned in a course of business and risk strategy, and shall cover the buffer set aside for the exceptional but plausible events, as a result of the stress tests.
- Erste Hungary has in place an internally approved and well-documented "new product approval policy" which addresses not only the development and approval of entirely new products but also significant changes in the features of existing products.
- The management and employees who perform risk related tasks under risk management must possess the knowledge and experience needed for their particular tasks. In addition the Bank ensured an enforcement of risk culture throughout the entire organisation.
- Risk management principles, methodologies, measurements and process must be in line with the Group standards and Hungarian supervisory requirements.

Given Erste Hungary's business strategy, the key risks for the Bank are credit risk, market risk and operational risk. Erste Hungary also focuses on managing liquidity, concentration and business risks. In addition to managing these risks, Erste Hungary's control and risk management framework takes account of the range of other significant risks faced by the Bank.

35.2. Risk management organisation

Risk monitoring and control is achieved through a clear organisational structure with defined roles and responsibilities, delegated authorities, bank wide risk culture and risk limits. The following diagram presents an overview of Erste Hungary’s risk management and control governance and responsibility structure.



Overview of Risk Management Structure

The Management Board and in particular Erste Hungary’s chief risk officer (“CRO”) has to define and implement comprehensive risk and business strategies as well as establish sound and clear risk management functions and policies. The CRO is responsible for the implementation of and adherence to the risk control and risk management strategies across all risk types and business lines. While the Management Board and in particular the CRO ensure the availability of appropriate infrastructure and staff as well as methods, standards and processes to that effect, the actual identification, measurement, assessment, approval, monitoring, steering and setting limits for the relevant risks are performed at the operating entity level within Erste Hungary. The CRO is supported by several divisions established to perform operative risk control functions and exercise strategic management responsibilities:

- Strategic Risk Management
- Retail Risk and Workout Management
- Corporate Risk Management
- Corporate Workout, Restructuring and Collateral Management
- Legal and Compliance Management
- Security Management.

Strategic Risk Management (SRM), which exercises the “risk control” function, is responsible for macro-managing the risk portfolios and the provision of adequate risk measurement methodologies and tools as well as an appropriate risk policy and control framework. Strategic Risk Management leads the ICAAP process, initiates a yearly review of the Risk Appetite Statement, contributes to the regular planning process and provides regular risk reporting to management, steering and operative functions of the institute. SRM is also responsible for the role of crisis management who defines the recovery plan framework, thus regularly monitors the management information and initiates the recovery plan in case of the trigger breaches.

Retail Risk and Workout Management focuses on retail business which is Erste Hungary's primary business. Retail Risk and Workout Management is responsible for the underwriting standards of micro and private individual customers for both secured and unsecured products and also portfolio monitoring and regular reporting about the portfolio quality and about the new acquisition quality. It has indicated department of underwriting of new loan acquisitions. Retail Workout is responsible for early and hard collection activity regarding the retail portfolio.

Corporate Workout, Restructuring and Collateral Management is the operative credit risk management function for Erste Hungary's corporate business. It is responsible for the formal and material verification, recommendation and approval of all corporate credit risks of Erste Hungary. Corporate Workout, Restructuring and Collateral Management is also responsible for credit risk management for all credit applications where the amount involved exceeds the approval limits granted to the respective subsidiary. This unit covers SMEs, municipalities, large corporate's, and real estate risks. Corporate Workout, Restructuring and Collateral Management provides specific credit risk reports on the aforementioned portfolios of Erste Hungary and is in charge of process development for corporate credit risk management and of the implementation of Erste Group standards for these asset classes. This department is also responsible for establishing and monitoring appropriate credit analysis as well as monitoring processes and systems for corporate business at the subsidiary level and coordinating and reviewing corporate credit and project analysis adopted across the business.

Corporate Workout, Restructuring and Collateral Management is covering also the counterparty risk management functions as well as the controls over market risks and liquidity risks. The department is approving and allocating the treasury limits for corporate and institutional clients, and also monitoring the daily exposures and limit violations. The market risk control area is monitoring the open foreign currency positions, the value at risk exposures and sensitivities in terms FX risks as well as in Interest Rate risks of Erste Hungary. As control tasks related to asset-liability management, the liquidity risk functions are also covered by Corporate Workout, Restructuring and Collateral Management area.

Corporate Workout, Restructuring and Collateral Management is responsible for solving problem credits in area of corporate and municipal customers. It has restructuring and workout of arms dealing with different levels problem clients.

Legal and Compliance Management, in performing the function of the central legal department of Erste Hungary, mitigates legal risk by providing legal support and counselling for the business and centre functions and by taking care of dispute resolution and litigation. Legal and Compliance Management has the focus on legal risk management and reporting aiming at identifying and minimizing, limiting or avoiding legal risk. Includes the functions Securities Compliance, Anti Money-Laundering (AML) and is accountable for addressing compliance risks. Compliance risks are risks of legal or regulatory sanctions, material financial loss, or loss to reputation Erste Hungary may suffer as a result of failure to comply with laws, regulations, rules and standards.

Security Management is in charge of the strategy, the definition of security standards, monitoring as well as the further development of issues of relevance for security at Erste Hungary.

In addition to the risk management activities performed at Erste Hungary level, larger subsidiaries also have risk control and management functions, the responsibilities of which are tailored to the applicable requirements.

Coordination of Risk Management Activities

Below functional committees are central to the Risk functions, to verify functionality of risk framework, or operationally monitor and manage various risk categories:

- Risk Governance Committee, which is a sub-committee of the Supervisory Board of Erste Hungary, is the most senior risk committee in Erste Hungary. It is responsible for the approval of methods and processes of risk control and management as well as for the risk infra-structure. The Risk Governance Committee also monitors the capital base and allocates capital at the macro level and determines the risk framework. As the central risk control body, the Risk Governance Committee is frequently and regularly briefed on the risk status, both retrospectively and prospectively, and across all risk types. The Risk Governance Committee analyses the current status as well as any trends and makes management decisions at the highest level. In line with the new Hungarian Banking Act (Act CCXXXVII of 2013.) valid from 1st of January 2014 EBH has established the Risk Governance Committee, thus EBH has terminated the Risk Committee as a subcommittee of the Supervisory Board and established a new, independent Risk Governance Committee. The new Risk Governance Committee is the successor of the former Risk Committee, but with the new duties and composition defined by the new Banking Act. which operates stringing from January 2014
- Operating Liquidity Committee (“OLC”), as a sub-committee of the ALCO, is responsible for the day-to-day management of the liquidity position of Erste Hungary. It analyses the liquidity situation of Erste Hungary on a regular basis and reports directly to the Asset Liability Committee (“ALCO”). It also proposes measures to the ALCO within the scope of the management policies and principles laid down in the Liquidity Risk Management Rule Book. Furthermore, members of the OLC are points of contact for other departments or Erste Hungary members for liquidity-related matters. For additional information on the ALCO, see “Liquidity Risk - Organisation and reporting”.
- Retail Risk Committee (hereafter RRC) is responsible for continuous supervision and decision over of the Bank’s retail risk taking rules, limits and risk parameters. The RRC is informed about the Risk Appetite statement of the management and responsible to develop and decide on retail risk strategy which derived from the risk tolerance. The RRC contributes to the internal capital assessment process.
- Corporate Risk Committee (hereafter CRC) is responsible for continuous supervision and decision over of the Bank’s corporate risk taking rules, limits and risk parameters. The CRC is informed about the Risk Appetite statement of the management and responsible to develop and decide on corporate risk strategy which derived from the risk tolerance. The CRC contributes to the internal capital assessment process. The CRC is the forum of discussions and decisions on new business initiatives, on application of new tools, systems or procedures in business and in risk management, on regular reports about the high priority business and risk projects in corporate banking area.
- Corporate Credit Committee (“CC”) is the main steering body for corporate credit risk related operations in Erste Hungary. The CC informs the Managing Board about the decisions it is taking on a monthly basis.
- Operational Risk Committee (“ORC”) approves and follows up risk mitigating measures arising from Operational Risk activities. The ORC meets quarterly and informs the Managing Board about its decisions on a quarterly basis.

In addition to the locally established committees, Erste Hungary’s CRO and Head of Strategic Risk Management participate in the CRO-Board and Group Enterprise-wide Risk Management Committee of Erste Group respectively. The CRO Board and the Group Enterprise-wide Risk Management Committee are responsible for consistent coordination and implementation of risk management activities within Erste Group. The CRO Board is made up of the CROs of the subsidiaries in the Erste Group. Chaired by the Group CRO, the CRO Board has responsibility for the coordination of risk management and for ensuring uniformity of risk management standards across Erste Group. The Group Enterprise-wide Risk Management Committee, which is made up of the division heads of the strategic risk management department at each subsidiary, provides support to the CRO Board in decision-making on current risk-related topics. The Group Enterprise-wide Risk Management Committee further operates a Holding Model Committee which controls and coordinates model development and approval process across the Group. Erste Hungary is represented in Holding Model Committee with a permanent member of senior analyst from Strategic Risk Management.

As a result of the principle of segregation of risk origination and risk control, at every level of the risk management structure of Erste Hungary - particularly concerning market and credit risks - the risk management and control functions are exercised independently of the front office functions

35.3. Risk Control

Overview of Risk Control Governance Structure

Objective of Strategic Risk Management, a unit that is independent from the business units, is to ensure that all type of risks measured and that they are within the limits approved by the Managing Board.

Enterprise Wide Risk Management which is a subunit of Strategic Risk Management plays a role in monitoring and aggregating the portfolio risk against the appetite level articulated in the Risk Appetite Statement of the institution. Objectives of the unit are

- ensure sound and comprehensive risk identification, measurement and risk aggregation methodologies
- develop comprehensive view on risk across business units and risk types
- provide forward looking perspective (planning) on material risks and integrate potential adverse scenarios (stress testing) into risk quantification
- quantified associated capital demand to quantified risk and asses capital supply potential of the institution, provide clear information to the management and initiate discussion over solvency and development of capital need (capital management)
- strengthen the risk culture in the institution

Risk Planning and Reporting Team has been established also as a subunit of the Strategic Risk Management, supporting regulatory reporting, external disclosures as well as internal management reporting for credit and operational risk, and limit utilisation monitoring on regular and ad hoc basis. It operates and develops risk infrastructure which incorporates central data collection and data processing, reconciliation and data aggregation capabilities. It assumes responsibility for measurement and reporting of risk while ensuring sufficient quality and integrity of risk related data.

Risk control process

Erste Hungary's independent risk control process consists of five main steps:

- Risk identification: refers to the detection of all relevant existing and potential risks related to banking operations, with particular emphasis on the use of a systematic and structured approach towards risk identification. The aim of this process is the permanent, timely, rapid, complete and cost-effective identification of each individual risk that has a bearing on the achievement by Erste Hungary of its business targets.
- Risk measurement: refers to the valuation and analysis of all quantifiable risks using statistical methods. In addition, stress scenarios are locally defined, with the goal of quantifying the losses that may be triggered by extremely adverse, rare, however plausible events.
- Risk aggregation: refers to the compilation of the results of risk measurement for each individual risk type to determine the aggregate potential loss based on the assumption of all of the relevant individual risks.
- Risk limit-setting: refers to the setting of a loss ceiling by the management through the Risk Committee based on the periodic determination of risk-bearing capacity, which takes into account the group's equity base and profitability status.
- Risk reporting refers to the continuous reporting of the risk measurement results for each individual risk type to management.

Basel II / Basel III

Having passed the required audit conducted by the Hungarian supervisory authority in 2008, Erste Hungary successfully qualified for Basel II internal ratings based (IRB) approach to the measurement of credit risk. For credit risk, Erste Hungary applies the Advanced IRB Approach in the retail segment and the Foundation IRB Approach in all other material Basel segments. (Standardized approach is used permanently for sovereign exposures, exposures against subsidiaries and immaterial portfolio elements)

Under Pillar 2 EBH applies internally estimated LGD parameters for material Basel II segments which indicate a more risk sensitive risk measurement under ICAAP framework.

For the operational risk Erste Hungary received regulatory approval to use the AMA (Advanced Measurement Approach) in the first half of 2009.

Erste Bank Hungary applies all risk management methods consistently also in its subsidiaries.

35.4. Risk and capital management

Overview

Erste Hungary implemented full set of policies and principles of Erste Group internal capital adequacy assessment framework. Comprehensive set of methods, processes and tools is called Enterprise-wide Risk Management (ERM) Framework which is designed to support the bank's management in assessing risk in portfolios as well as the coverage potential to assure at all times an adequate capital capacity reflecting the nature and magnitude of the Bank's risk portfolio. ERM is tailored to the Erste Hungary's business and risk profile, reflects the strategic goal of protecting share- and senior debt holders and ensuring sustainability of the organisation.

ERM is a modular and comprehensive steering and management system within Erste Hungary and is integral to the Bank's / Erste Hungary's overall steering and management system. The components necessary to ensure all aspects of ERM, regulatory requirements but particularly internal value adding needs, can be summarised as follows:

- Risk Strategy and Risk Appetite
- Portfolio & Risk Analytics e.g.
- Risk Materiality Assessment
- Risk Modelling & Stress Testing
- Risk-bearing Capacity Calculation
- Risk Planning & Forecasting e.g.
- RWA Management
- Capital Allocation

Risk Strategy and Risk Appetite

Erste Bank Hungary defines its risk strategy and Risk Appetite Statement (RAS) through the group-wide annual strategic planning process to ensure appropriate alignment of risk, capital and performance targets. The RAS represents a strategic statement expressing the maximum level of risk that Erste Hungary is prepared to accept in order to deliver its business objectives. It consists of a set of key risk appetite measures providing quantitative direction for risk steering, from which a top-down boundary for target and limit setting is derived, creating a holistic perspective on capital, funding and risk-return trade-offs, and qualitative statements in the form of key risk principles that form part of the strategic guidelines for managing risks. The key objective of RAS is to:

- ensure that Erste Hungary has sufficient resources to support business at any given point in time and absorb stress market events
- set boundaries of the Erste Hungary's risk-return target setting
- preserve and promote the market's perception of the Erste Hungary's financial strength and the robustness of its systems and controls

Key RAS measures include general indicators (i.e. capital, leverage, etc.) as well as indicators for credit market operational and liquidity risk. To ensure that the RAS is operationally efficient, the indicators are classified as either targets, limits or principles, where the main differences are in the mechanisms triggered in case of a breach of the RAS. Local RAS is aligned with the Holding RAS in order to ensure the group-wide consistency of the business targets and risk appetite.

Portfolio and Risk Analytics

For the purpose of adequate management of the group's risk portfolios according to the strategy, risks are systematically analysed within the scope of portfolio & risk analytics. Risks are quantified, qualified and discussed in a consistent management process in order to decide on appropriate measures on time.

Risk Materiality Assessment

Its purpose is the systematic and continuous assessment of all relevant risk types and the identification of risks which are significant for the Bank. Erste Hungary has adapted a clear and structured Risk Materiality Assessment approach which is based on defined quantitative and qualitative factors for each risk type. It measures the impact of the risk type by historical experience, volatility and vulnerability but in build forward looking expectation on these measures as well. It also assess the quality of measurement methods and control processes such as the ability of the institution to mitigate the given risk type.

This process constitutes the basis for the determination of material risk types to be included in the Risk-bearing Capacity Calculation. Insights generated by the assessment are also used to improve risk management practices per se to further mitigate risks within the group but also as an input for the design and definition of the group's Risk Appetite Statement.

Risk Modelling and Stress Testing

Modelling the existing risks and the detection of potential negative movements at an early stage as well as conducting Stress Tests is a part of the ERM framework. Erste Hungary additionally participated in a variety of stress test exercises. The results of these stress tests showed that Erste Hungary's regulatory capital was adequate.

Risk-bearing Capacity Calculation

Within the Risk-bearing Capacity Calculation, Erste Hungary's material risks are compared to the capital/coverage potential according to internal ICAAP standards. The quarterly capital adequacy calculation undertaken by Erste Hungary serves not only as a tool to assess the actual capital adequacy of the group but also to provide a forward-looking picture, make recommendations and start taking actions as may be necessary for a sustainable sound capitalisation.

The Management Board and the risk management committees are briefed regularly and at least on a quarterly basis in relation to the results of the capital adequacy calculation. The report includes movements in risks and available capital / coverage potential after consideration of potential losses in stress situations, the degree of utilisation of the risk limit and overall status of ICAAP according to the traffic light system.

Based on the business and risk profile of Erste Hungary, most of the material types of banking risks, credit risk, market risk both in trading and banking book, operational risk and business risk are considered in the Risk-bearing Capital Calculation. Credit risk accounts for approximate 65% of the total economic capital requirement. Reflecting what management believes is the conservative risk management policy and strategy of Erste Hungary, Erste Hungary does not offset diversification effects between the risk types. The economic capital requirement for unexpected losses is computed on a one-year time horizon with 99.9% confidence level.

Other risk types, in particular liquidity, concentration and reputational risks, are managed by means of a proactive management framework that includes forward-looking elements, stress testing, trigger levels and traffic light systems.

The capital or coverage potential required to cover economic risks and unexpected losses is subdivided based on the characteristic of their components, such as the legal qualification of the source of capital and the tenor of subordinated debt. The coverage potential must be sufficient to absorb unexpected losses resulting from the Erste Hungary's operations.

Risk Planning and Forecasting

The responsibility for risk management within the Erste Hungary includes ensuring sound risk planning and forecasting processes. The forecasts determined by risk management are the result of close co-operation with all stakeholders in the Erste Bank Hungary's overall planning process, and in particular with Controlling Department, Asset Liability Management and the business lines. The risk planning and forecasting process includes both a forward- and backward-looking component, focusing on both portfolio and economic environment changes.

A particular role and forward-looking element is played by the rolling one-year forecast within the RCC which is vital in determining the trigger level of the traffic light system.

Risk exposure management

As total risk exposure amount (TREA) determines the actual regulatory capital requirement of a bank and influence the capital ratio as a key performance indicator, particular emphasis is devoted to meeting targets and to the planning and forecasting capacity for this parameter. Insights from monthly risk exposure analyses are used to improve the calculation infrastructure, the quality of input parameters and data as well as the most efficient application of the Basel framework.

There is a process in place for tracking compliance with risk exposure targets, forecasting their future developments and thereby defining further targets. Deviations are brought to the attention of the board within a short time frame. In addition to discussions in the steering committee, the management board is regularly informed about the current status, and findings are taken into account in the context of Erste Bank Hungary's regular steering process. Furthermore, risk exposure targets are included in the Risk Appetite Statement.

Capital allocation

An important task integral to the risk planning process is the allocation of capital to entities, business lines and segments. This is done with close co-operation between Risk Management and Controlling. All insight from the ICAAP and controlling processes is used to allocate capital with a view to risk-return considerations.

35.5. Recovery plan

The Hungarian Supervisor required the Hungarian banks, including Erste Bank Hungary to develop a recovery plan in line with the EBA and HFSA recommendations. Erste Bank Hungary submitted the first version of its recovery plan in October 2013 and the detailed documentation in February 2014. Institutions required to prepare a recovery plan have to update it on a yearly basis, the latest updated version reflecting recent development of the economic environment in which Erste Bank Hungary operates was submitted in September 2016. Erste Bank Hungary Recovery Plan 2017 describes the governance structure serving development and regular update of Erste Hungary's recovery plan, the potential stresses jeopardising the capital or liquidity position of the Erste Hungary as well as the possible measures, in quantified form, to maintain or restore stable financial positions if it is necessary.

35.6. Credit risk

Definition and overview

Credit risk arises in Erste Hungary's traditional lending business, comprising losses incurred as a result of default by the borrowers or by the need to set aside provisions as a result of the deteriorating credit quality of certain borrowers, as well as from trading in market risk instruments (counterparty risk). Operative credit decisions are made by the decentralised credit risk management units, namely corporate risk. See 'Risk Management Organisation - Overview of Risk Management Structure' for a detailed explanation of the role and responsibilities of Corporate Risk Management.

The Strategic Risk Management Directorate of Erste Hungary regularly prepares reports on credit portfolio for external and internal audiences and permits continuous monitoring of credit risk developments, enabling management to take control measures. In-house recipients of these reports include, above all, the Supervisory Board and Managing Board of Erste Hungary, as well as the risk managers, business unit directors and internal audit staff.

Internal rating system

Overview

Erste Hungary has business and risk strategies in place for lending policies and credit approval processes. They cover the entire lending business, taking into account the nature, scope and risk level of the transactions and the counterparties involved. Credit approval is also based on the creditworthiness of the customer, the type of credit, collateral, covenant package and other risk mitigation factors involved.

The assessment of counterparty default risk within Erste Hungary is based on probability of default ('PD'). For each credit exposure and lending decision, Erste Hungary assigns an internal rating, which is a unique measure of counterparty default risk. Internal rating of each customer is updated at least on an annual basis (Annual Rating Review). Rating of a customer in weaker rating classes is reviewed with higher frequency than the usual Annual Rating Review.

The main purpose of the Internal Ratings is to affect the decision-making for lending and the terms of the credit facility to be extended; however, Internal Ratings also determine the level of decision-making authority within Erste Hungary and the monitoring procedures for existing exposures. At a quantitative level, Internal Ratings drive the level of required risk pricing and risk provisions. Internal Ratings are a key element of risk weighted assets' calculation and Internal Capital Adequacy Assessment Process ('ICAAP').

Internal Ratings take into account all available essential information for assessment of counterparty default risk. For non-retail borrowers, Internal Ratings take into account financial strength of the counterparty, possibility for external support, company information, and external credit history information, where available. For the wholesale segment, Internal Ratings also take into account market information such as access to capital markets. For retail clients, Internal Ratings are based mainly on behavioural and application scoring, but also utilise demographic and financial information. Rating ceiling rules on credit quality are applied based on country domicile and membership in a group of economically related entities.

Internal Rating models and risk parameters are developed by internal teams of specialists. Rating development follows internal methodology formalised into an Erste Group wide methodology and documentation standard (White Paper). Rating models are developed based on

relevant and most accurate data covering always the respective market. In such a way Erste Hungary established highly predictive rating models.

All scorecards of Erste Hungary, whether retail or non-retail, are regularly validated based on standard methodology of Erste Group. Validations are provided by a specialized Competence Centre using statistical techniques in respect to default prediction performance, rating stability, data quality, completeness and relevancy and last but not least the review of documentation and user acceptance. The results of this validation process are reported to the management and regulatory bodies. In addition to the validation process, a monitoring process is also in place on the performance of rating tools, reflecting the month-to-month new defaults and any early delinquencies.

The model development and maintenance process is supervised by Holding Model Committee of Erste Group which is established as an Erste Group-wide elementary steering and control body covering also Erste Hungary. All new models (rating models and risk parameters) and methodology standards in Erste Group are reviewed by the Holding Model Committee. Holding Model Committee ensures integrity and consistency of models and methodologies. Beside of review function of new models and methodologies, Holding Model Committee organises validation process, reviews validation results and approves remedy actions. All development and validation activities are coordinated by the organisational unit 'Risk Methods and Models'.

Risk Grades and Categories

The classification of credit assets into risk grades is based on Erste Hungary's Internal Ratings. Erste Hungary uses two internal risk-scales for risk classification: for customers that have not defaulted, a risk scale of eight risk grades (for retail) and 13 risk grades (for all other segments) is used. Defaulted customers are classified in one risk grade.

For the purpose of external reporting, Erste Hungary developed a framework to map the risk grades into four different risk categories, as follows:

- Low risk: Typically regional customers with a well-established and rather long standing relationship with Erste Hungary or large internationally recognised customers, characterised by strong and good financial health, without any foreseeable financial difficulties. Retail clients with long relationship with the Bank, or clients with a wide product pool use. No late payments currently or in the most recent twelve months. New business is generally with clients in this risk category.
- Management attention: Vulnerable non-retail clients, which may have overdue payments/defaults in their credit history or which may encounter debt repayment difficulties in the medium-term, having limited savings or probable past payment problems triggering early collection reminder. These clients typically have a good recent history and no current delinquency.
- Substandard: The borrower is vulnerable to negative financial and economic developments; such loans are managed in specialised risk management departments.
- Non-performing: One or more of the default criteria under Basel II are met: full repayment unlikely, interest or principal payments on a material exposure more than 90 days past due, restructuring resulting in a loss to the lender, realisation of a loan loss, or initiation of bankruptcy proceedings. For corporate borrowers in Hungary, the customer view is also applied - if a customer defaults on one product then all of that customer's per-forming products are classified as non-performing. However, in the retail and SME segment Erste Hungary uses the 'product view', so that only the product actually in default is counted as a NPL whereas the other products of the same customer are considered performing.

Erste Hungary assigns to each rating grade a distinct PD value within the calibration process. Calibration is performed individually for each rating method. PD values reflect the twelve month expectation of long term average default rates. Additionally to the PD values the bank assigns margin of conservatism dependent on the granularity of portfolios and relevant data history. Calibration of PD values is validated on a yearly basis in line with all the rating methods validations. Any change in the calibration of the PD values must be approved in the Holding Model Committee together with all the model changes.

Impairment assessment

The general principles and standards for credit risk provisions within Erste Hungary are described in internal policies.

Erste Bank Hungary evaluates the need for credit risk provisions in line with regulatory and accounting standards and allocates them accordingly. Credit risk provisions are calculated

- for financial assets carried at amortised cost (loans and receivables, financial assets held to maturity)

- for contingent liabilities (financial guarantees, loan commitments)
- for financial assets – available for sale

For accounting purposes Erste Hungary uses an incurred loss model for the recognition of losses on impaired financial assets. This means that losses can only be recognised when objective evidence of a specific loss event has been observed. Triggering events include the following:

- Significant financial difficulty of the customer
- A breach of contract such as a default of payment
- It becomes probable that the customer will enter bankruptcy or other financial reorganisation
- Observable data that suggests that there is a decrease in the estimated future cash flows from the loans

Credit risk provisions are created on a deal level in an assessment process performed monthly. The process includes the identification of default and impairment and the type of assessment (individual or collective) to be applied. Depending on the characteristics of the exposure and the respective expected cash flows (e.g. considering collateral), some exposures may not be impaired.

The bank distinguishes between

- specific allowances calculated for non performing exposures that are deemed to be impaired, and
- Collective allowances (allowances for incurred but not reported losses) calculated for performing exposures or non-performing loans that are not deemed to be impaired.

For the calculation of specific allowances, the discounted cash flow method is applied. This means that a difference between carrying amount and net present value (NPV) of the expected cash flows leads to an impairment and defines the amount of any allowance requirement. All estimated interest and redemption payments as well as estimated collateral recoveries and costs for selling and obtaining collateral are considered as expected cash flows. The effective interest rate is used as the discount rate in the calculation of the NPV of the expected cash flows.

The calculation of specific allowances is performed either on an individual basis or as a collective assessment (rule-based approach). In case of significant customers, expected cash flows are estimated individually by workout or risk managers. A customer is considered as significant if the total exposure defined as the sum of all on- and off-balance-sheet exposures exceeds the materiality limit of 50 million forint. Otherwise, the customer is considered as insignificant and a rule-based approach is used for the calculation of the specific allowance. Under this approach, specific allowances are calculated as the product of carrying amount and loss given default (LGD), where LGD depends on relevant characteristics such as time in default, loan to value information or the stage of the workout process.

Collective allowances are calculated on performing on- and off-balance-sheet exposures for which a default event has not been detected or reported. The level of collective allowances depends on the carrying amount, the probability of default (PD), the loss given default (LGD), the credit conversion factors (CCF) in case of off-balance-sheet exposures, and the loss identification period (LIP). The LIP corresponds to the average period between the occurrence and the detection of the loss and ranges from four months to one year. The result of discounting future cash flows to their present values is taken into consideration in the LGD calculation.

Collective allowances are also calculated in case of non performing exposures that are not identified as impaired. For these customers, no specific allowances are allocated.

Erste Hungary regularly reviews its specific and collective allowances. These exercises comprise the parameters and methodologies used in its provision calculation. Adjustments can take place in the context of specific reviews (in view of specific allowances), routine maintenance of parameters (such as regular calibration) or in the case of specific events (e.g. improved knowledge about recovery behaviour, back-testing results).

Materiality threshold

Erste Hungary, in line with Erste Group standards, implemented a materiality threshold differentiating between individually significant and individually not significant exposure. Materiality threshold is defined as 50 million forint of client exposure or any equivalent value in foreign currency.

Individually assessed allowances

Erste Hungary determines the allowances appropriate for each individually significant loan or advance on an individual basis, including any overdue payments of interests, credit rating downgrades, or infringement of the original terms of the contract. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance if it is in a financial difficulty, projected receipts and the expected pay out should bankruptcy ensue, the availability of other financial support, the realisable value of collateral and the timing of the expected cash flows. Impairment allowances are evaluated at each reporting date, unless unforeseen circumstances require more careful attention. Trigger event for the assessment is a default.

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances that are not individually significant (including credit cards, residential mortgages and unsecured consumer lending) and for individually significant loans and advances that have been assessed individually and found not to be impaired.

Erste Hungary generally bases its analyses on historical loss experience with reference to current situation in underwriting and recovery processes and market reality. In cases of significant changes on market or internal processes Erste Hungary concludes of review of assumptions and parameters of collective impairment.

Allowances are evaluated separately at each reporting date with each portfolio.

The collective assessment is made for groups of assets with similar risk characteristics, in order to determine whether provision should be made due to incurred loss events for which there is objective evidence, but the effects of which are not yet evident in the individual loans assessments. The collective assessment takes account of data from the loan portfolio (such as historical losses on the portfolio, levels of arrears, credit utilisation, loan to collateral ratios and expected receipts and recoveries once impaired). For secured defaulted portfolio the recovery expectation is derived from applied workout strategy. Workout unit assigns to all loans the possible workout treatments including success rate (probability of realization) and recovery rate (cash inflow / actual outstanding).

The approximate delay between the time a loss is likely to have been incurred and the time it will be identified is translated into a Loss Identification Period (LIP) coefficient. Local management is responsible for deciding the length of this period and LIP factor, which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the bank's overall policy.

Financial guarantees and letters of credit are assessed in a similar manner as for loans.

Credit Risk Review and Monitoring

Credit Monitoring

In order to manage the credit risk for large corporates, banks, sovereigns and country risk, credit limits are established to reflect the maximum exposure Erste Hungary is willing to take on that particular customer or the group of connected customers. All credit limits and the exposures booked within the limits are reviewed at least once a year. For small corporate's and retail customers, monitoring and credit review is based on a rating model, which is updated monthly.

Portfolio reports for asset classes and business lines are prepared on regular basis Watch-list meetings or remedial committee meetings are held on a regular basis to discuss customers with weak ratings or to discuss preventive measures to help a particular client avoid default.

For retail business, Retail Risk and Workout Management is responsible to undertake these monitoring activities and fulfil the minimum requirements of Erste Hungary retail risk.

Credit Exposure

Credit exposure relates to the following items of Statement of Financial Position:

- loans and receivables to credit institutions
- loans and receivables to customers
- financial assets held for trading, available for sale and held to maturity
- positive fair value of derivative financial instruments
- credit risks related off-balance sheet (contains guarantees and irrevocable committed credit lines).

The credit exposure comprises the gross amount without taking into account any collateral held, other credit enhancements or credit risk mitigating transactions.

Erste Hungary's total credit exposure is presented below divided into the following classes:

- by industry
- by risk category
- by industry and risk category
- by business segment and risk category.

Following this detailed breakdown of credit risk exposure, Erste Hungary presents a detailed breakdown

- of its non-performing assets and risk provisions
- of its loans and advances to customers by business segment.

Analysis of risk concentration

- Concentrations arise when a number of clients are engaged in similar business activities, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.
- Concentrations indicate the relative sensitivity of the Erste Hungary's performance to developments affecting a particular industry.
- In order to avoid excessive concentrations of risk, Erste Hungary's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.
- Erste Hungary's concentration of risk is managed by industry sector and by business segment/client.

Credit exposure (gross carrying amount) by industry 2016

in HUF million	Other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Financial assets - held to maturity	Other trading assets	Financial assets - available for sale	Derivatives	Off balance sheet	Total credit risk exposure
			At amortised cost			Fair value			
Agriculture, forestry and fishing	-	-	27,481	-	-	-	7	649	28,138
Mining and quarrying	-	-	12,537	-	-	-	-	807	13,344
Manufacturing	-	-	73,898	-	6	-	790	56,477	131,172
Electricity, gas, steam and air conditioning supply	-	-	6,008	-	258	-	55	2,118	8,439
Water supply	-	-	3,178	-	-	-	-	99	3,277
Construction	-	-	5,424	-	-	-	-	6,720	12,144
Wholesale and retail trade	-	-	49,200	-	-	-	21	9,123	58,343
Transport and storage	-	-	20,015	-	-	-	9	296	20,320
Accommodation and food service activities	-	-	11,793	-	-	-	-	78	11,871
Information and communication	-	-	1,356	-	26	-	0	63	1,446
Financial and insurance services	11,048	145,499	6,558	4,526	434	26,614	10,498	47	205,225
Real estate activities	-	-	169,182	-	-	-	2,869	24,294	196,345
Professional, scientific and technical activities	-	-	9,230	-	-	-	-	1,028	10,258
Administrative and support service activities	-	-	3,587	-	-	-	-	514	4,101
Public administration and defence, compulsory social security	-	-	1,369	432,142	116,055	110,356	-	60,000	719,923
Education	-	-	1,816	-	-	-	-	-	1,816
Human health services and social work activities	-	-	446	-	879	-	-	3	1,328
Arts, entertainment and recreation	-	-	690	-	-	-	-	-	690
Other services	-	-	21,597	-	-	-	-	9	21,605
Private households	-	-	673,964	-	-	-	-	29,632	703,596
Others	-	-	1,104	-	-	779	1,149	-	3,032
Total	11,048	145,499	1,100,435	436,668	117,658	137,749	15,397	191,958	2,156,413

Credit exposure (gross carrying amount) by industry 2015

in HUF million	Other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Financial assets - held to maturity	Other trading assets	Financial assets - available for sale	Derivatives	Off balance sheet	Total credit risk exposure
		At amortised cost			Fair value				
Agriculture, forestry and fishing	-	-	26,393	-	-	-	8	64	26,465
Mining and quarrying	-	-	155	-	-	-	-	1,821	1,976
Manufacturing	-	-	35,280	-	29	-	400	9,823	45,532
Electricity, gas, steam and air conditioning supply	-	-	11,105	-	403	-	44	27,146	38,698
Water supply	-	-	8,859	-	-	-	-	31	8,890
Construction	-	-	3,038	-	-	-	-	9,151	12,190
Wholesale and retail trade	-	-	39,546	-	-	-	11	4,943	44,500
Transport and storage	-	-	12,779	-	-	-	5	842	13,626
Accommodation and food service activities	-	-	6,190	-	-	-	-	37	6,228
Information and communication	-	-	1,409	-	16	-	1	47	1,472
Financial and insurance services	14,399	278,436	24,377	4,579	145	30,472	7,527	172	360,107
Real estate activities	-	-	188,305	-	93	-	2,777	15,373	206,549
Professional, scientific and technical activities	-	-	7,084	-	-	-	1	1,336	8,422
Administrative and support service activities	-	-	2,751	-	-	-	47	479	3,277
Public administration and defence, compulsory social security	-	-	12,072	290,152	57,204	58,299	-	60,000	477,726
Education	-	-	1,948	-	-	-	-	1	1,949
Human health services and social work activities	-	-	486	-	143	-	-	39	668
Arts, entertainment and recreation	-	-	762	-	-	-	-	1	763
Other services	-	-	17,210	-	-	-	0	40	17,249
Private households	-	-	728,286	-	-	-	(0)	20,147	748,434
Others	-	-	1,263	-	-	784	23	-	2,070
Total	14,399	278,436	1,129,298	294,731	58,034	89,555	10,846	151,492	2,026,790

Credit Exposure (gross carrying amount) by Risk Category

The following table presents the total credit risk exposure (gross carrying amount) of Erste Hungary by risk category as of 31 December 2016.

Credit exposure (gross carrying amount) by risk category

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Credit risk exposure December 2016	1,827,373	171,846	34,472	122,722	2,156,413
Share of credit risk exposure	84.7%	8.0%	1.6%	5.7%	100.0%
Credit risk exposure December 2015	1,579,729	193,820	36,803	216,439	2,026,790
Share of credit risk exposure	77.8%	9.6%	1.8%	10.7%	100.0%
Change in credit risk exposure in 2016	244,824	(19,143)	(2,331)	(93,728)	129,622
Change	15.5%	-9.9%	-6.3%	-43.3%	6.4%

Material change in non-performing category is due to the 'Large debt sale' see in Note 25, page 46.

Also contributing to the decrease in non-performing category the individual debt sale in corporate portfolio amounted to 32 billion forint. Clients presented no delay within a 12 months post default period were upgraded in the first semester of 2016, meaning a further decrease of 14 billion forint in the non-performing category.

Credit Exposure by Industry and Risk Category

The following tables present the total credit risk exposure (gross carrying amount) of Erste Hungary broken down by industry and risk category:

Credit exposure by industry and risk category in 2016

in HUF million	Low risk	Management attention	Substandard	Non-performing	Credit risk exposure
Agriculture, forestry and fishing	20,385	7,533	2	219	28,138
Mining and quarrying	12,809	534	1	-	13,344
Manufacturing	117,908	9,368	407	3,488	131,172
Electricity, gas, steam and air conditioning supply	6,292	63	1	2,083	8,439
Water supply	1,463	91	0	1,723	3,277
Construction	8,966	2,802	26	350	12,144
Wholesale and retail trade	47,018	9,340	193	1,792	58,343
Transport and storage	15,778	3,969	14	559	20,320
Accommodation and food service activities	10,635	575	529	132	11,871
Information and communication	981	252	21	192	1,446
Financial and insurance services	190,149	15,014	-	62	205,225
Real estate activities	129,422	15,054	13,567	38,302	196,345
Professional, scientific and technical activities	8,220	1,581	121	336	10,258
Administrative and support service activities	2,360	697	51	993	4,101
Public administration and defence, compulsory social security	719,088	0	-	834	719,923
Education	221	5	1,590	0	1,816
Human health services and social work activities	1,273	49	0	6	1,328
Arts, entertainment and recreation	138	501	2	50	690
Other services	18,148	3,179	13	265	21,605
Private households	513,149	101,236	17,935	71,276	703,596
Others	2,969	5	-	58	3,032
Total	1,827,373	171,846	34,472	122,722	2,156,413

Credit exposure by industry and risk category in 2015

in HUF million	Low risk	Management attention	Substandard	Non-performing	Credit risk exposure
Agriculture, forestry and fishing	20,312	5,794	13	346	26,465
Mining and quarrying	1,849	124	0	2	1,976
Manufacturing	35,274	7,061	754	2,443	45,532
Electricity, gas, steam and air conditioning supply	34,803	1,035	1,728	1,132	38,698
Water supply	982	310	160	7,438	8,890
Construction	10,278	1,031	94	786	12,190
Wholesale and retail trade	34,977	7,053	456	2,015	44,500
Transport and storage	12,210	769	14	633	13,626
Accommodation and food service activities	4,166	1,175	499	388	6,228
Information and communication	577	662	85	148	1,472
Financial and insurance services	353,886	5,569	1	651	360,107
Real estate activities	74,286	52,142	13,532	66,590	206,549
Professional, scientific and technical activities	3,983	1,232	2,984	222	8,422
Administrative and support service activities	2,409	734	66	67	3,277
Public administration and defence, compulsory social security	477,722	0	0	4	477,726
Education	291	5	1,649	4	1,949
Human health services and social work activities	595	62	2	9	668
Arts, entertainment and recreation	36	645	19	63	763
Other services	13,648	121	3,092	389	17,249
Private households	495,491	108,264	11,644	133,034	748,434
Others	1,952	32	10	76	2,070
Total	1,579,729	193,820	36,803	216,439	2,026,790

Credit exposure of loans and receivables to customers and non-performing loans (NPL) coverage by segment

Local Retail contains in addition to 'Private household' the so called micro customers.

Credit exposure of loans and receivables to customers (gross carrying amount) by business segment and risk category in 2016

in HUF million	Low risk	Management attention	Substandard	Non-performing	Loans to customers
Local Retail	494,098	99,023	18,222	71,108	682,451
Local Corporate	132,386	34,989	414	12,433	180,222
Group Corporate Center	1	-	-	-	1
Group Large Corporate	47,470	178	-	0	47,648
Local Real Estate	123,620	16,103	15,630	21,491	176,845
Group Markets	13,063	197	-	8	13,268
Total	810,638	150,490	34,266	105,041	1,100,435

Credit exposure of loans and receivables to customers (gross carrying amount) by business segment and risk category in 2015

in HUF million	Low risk	Management attention	Substandard	Non-performing	Loans to customers
Local Retail	485,074	108,436	12,176	133,776	739,462
Local Corporate	98,400	27,263	8,526	17,224	151,414
Group Corporate Centre	10	906	-	0	917
Group Large Corporate	50,064	4,141	253	1,723	56,182
Local Real Estate	64,645	35,300	15,744	54,366	170,055
Group Markets	11,260	-	-	8	11,269
Total	709,454	176,048	36,699	207,097	1,129,298

Material change in non-performing category is due to the 'Large debt sale' see in Note 25, page 46.

Non-performing loans and receivables to customers by business segment and coverage by risk provisions and collateral December 2016

in HUF million	Non-performing	Loans to customers	Risk provisions	NPL ratio	NPL coverage ratio	Collateral for NPL	NPL total coverage ratio
Local Retail	71,108	682,450	(49,630)	10.4%	69.8%	45,625	134.0%
Local Corporate	12,433	180,222	(9,115)	6.9%	73.3%	4,996	113.5%
Group Corporate Center	-	1	-	0.0%	-	-	0.0%
Group Large Corporate	0	47,648	(379)	0.0%	166787.6%	-	166787.6%
Local Real Estate	21,491	176,845	(20,067)	12.2%	93.4%	4,366	113.7%
Group Markets	8	13,269	(12)	0.1%	100.0%	-	100.0%
Total	105,041	1,100,435	(79,203)	9.5%	75.4%	54,986	127.7%

Non-performing loans and receivables to customers by business segment and coverage by risk provisions and collateral December 2015

in HUF million	Non-performing	Loans to customers	Risk provisions	NPL ratio	NPL coverage ratio	Collateral for NPL	NPL total coverage ratio
Local Retail	133,776	739,462	(69,262)	18.1%	51.8%	92,899	121.2%
Local Corporate	17,224	151,414	(12,723)	11.4%	74.1%	3,946	97.0%
Group Corporate Centre	0	917	(23)	0.0%	30661.2%	0	30661.2%
Group Large Corporate	1,723	56,182	(1,801)	3.1%	104.5%	791	150.4%
Local Real Estate	54,366	170,055	(38,878)	32.0%	71.4%	11,115	91.9%
Group Markets	8	11,269	(8)	0.1%	100.0%	0	100.0%
Total	207,097	1,129,298	(122,696)	18.3%	59.2%	108,752	111.8%

Material change in non-performing category is due to the 'Large debt sale' see in Note 25, page 46.

Restructuring, renegotiation and forbearance

Restructuring means contractual modification of any of the customer's loan repayment conditions including tenor, interest rate, fees, principle amount due or a combination thereof. Restructuring can be business restructuring or forbearance in line with EBA requirements.

Business restructuring

Restructuring as business restructuring is a potential and effective customer retention tool involving re-pricing or the offering of an additional loan or both in order to maintain the bank's valuable, good clientele.

Forbearance

The definition of 'forbearance' is included in Regulation (EU) 227/2015. A restructuring is considered 'forbearance' if it entails a concession towards a customer facing or about to face financial difficulties in meeting their contractual financial commitments. A borrower is in financial difficulties if any of the following conditions are met:

- the customer was more than 30 days past due in the past 3 months or
- the customer would be 30 days past due or more without receiving forbearance or
- the customer is in default or
- the modified contract was classified as non-performing or would be non-performing without forbearance or
- the contract modification involves total or partial cancellation by write-off of the debt on any of the customer's credit obligations while at customer level open credit exposure still remains.

Forborne exposure is assessed at loan contract level and means only the exposure to which forbearance measures have been extended and excludes any other exposure the customer may have, as long as no forbearance was extended to these.

Concession means that any of the following conditions are met:

- Modification/refinancing of the contract would not have been granted, had the customer not been in financial difficulty;
- There is a difference in favour of the customer between the modified/refinanced terms of the contract and the previous terms of the contract
- The modified/refinanced contract includes more favourable terms than other customers with a similar risk profile would have obtained from the same institution.

Forbearance can be initiated by the bank or by the customer (on account of loss of employment, illness etc.). Components of forbearance can be instalment reduction, tenor extension, interest reduction or forgiveness, principal reduction or forgiveness, revolving exposure change to instalment and/or others.

Forbearance measures are divided and reported as:

- Performing forbearance (incl. performing forbearance under probation that was upgraded from non-performing forbearance)
- Non-performing forbearance (incl. non-performing forbearance and defaulted/impaired forbearance)

Forborne exposures are considered performing when

- the exposure did not have non-performing status at the time the extension of or application for forbearance was approved and
- granting the forbearance has not led to classifying the exposure as non-performing or default

Performing forborne exposures become non-performing when during the monitoring period of a minimum of 2 years following forbearance classification

- an additional forbearance measure is extended and in the past the customer was in the non-performing forbearance category or
- the customer becomes more than 30 days past due on forborne exposure and in the past the customer was in the non-performing forbearance category or
- the customer meets any of the default event criteria defined in Erste Group's internal default definition

The performing forbearance classification can be discontinued and the account can become a non-forborne account when all of the following conditions are met:

- a minimum of 2 years have passed from the date of classifying the exposure as performing forbearance (probation period);
- under the forborne payment plan, at least 50% of the original (pre-forbearance) instalment has been regularly repaid at least during half of the probation period (in the case of retail customers) or

- _ regular repayments in a significant amount during at least half of the probation period have been made (in the case of corporate customers);
- _ none of the exposure of the customer is more than 30 days past due at the end of the probation period.

The non-performing forbearance classification can be discontinued and reclassified as performing under probation when all of the following conditions are met:

- _ One year has passed from the date of classifying the exposure as non-performing forbearance
- _ The forbearance has not led the exposure to be classified as non-performing
- _ Retail customers: the customer has demonstrated the ability to comply with the post-forbearance conditions by either of the following
 - _ The customer has never been more than 30 days past due during the last 6 months and there is no delinquent amount or
 - _ The customer has repaid the full past due amount or the written-off amount (if there was any)
- _ Corporate customers: analysis of the financial development, which leaves no concern about future compliance with post-forbearance terms and conditions. Furthermore, the customer has never been more than 30 days past due during the monitoring period and there is no delinquent amount.

In the corporate segment, recognition of forbearance measures typically leads to the involvement of the responsible local workout unit. The largest part of the forbearance measures is set within the responsibility of the local workout units and the affected clients are managed and monitored according to the internal regulations and standards for the workout involvement. Forbearance measures are defined as trigger events for carrying out impairment tests according to the internal regulations and standards based on the IFRS requirements.

Forbearance rules were implemented for the bank in 2015. For 2014 the Bank considered restructured cases as forborne, if they were in default at the time of restructuring or overdue with more than 30 days after restructuring.

Gross forborne exposures 2016

As of 31 December 2016	Gross forborne exposure	Modification in terms and conditions	Refinancing
Loans and advances excl. Financial assets - held for trading	42,698	33,125	9,573
Debt Instruments excl. Financial assets - held for trading	1,326	1,326	-
Loan commitments	9	9	-
Total	44,032	34,459	9,573

Gross forborne exposures 2015

As of 31 December 2015	Gross forborne exposure	Modification in terms and conditions	Refinancing
Loans and advances excl. Financial assets - held for trading	58,378	58,013	365
Debt Instruments excl. Financial assets - held for trading	1,475	1,475	-
Loan commitments	20	20	-
Total	59,873	59,508	365

Credit quality of forbearance exposure

	Gross forborne exposure	Neither past due nor impaired	Past due but not impaired	Impaired	Collateral	Credit risk provision
As of 31 December 2016	44,032	23,601	2,564	17,867	14,899	14,696
As of 31 December 2015	59,873	26,228	2,718	30,927	10,843	19,486

Credit risk exposure by business segment and collateral December 2016

in HUF million	Credit risk exposure	Collateral and other credit risk mitigation				Credit risk exposure net of collateral
		Collateral total	Guarantees	Real estate	Other	
Local Retail	769,888	433,824	2,485	392,997	38,341	336,064
Local Corporate	256,591	152,620	68,228	29,226	55,167	103,971
Group Corporate Centre	1	-	-	-	-	1
Group Large Corporate	111,839	6,904	0	-	6,904	104,936
Local Real Estate	203,194	68,874	0	67,187	1,687	134,320
Group Markets	814,899	6,703	6,282	17	404	808,196
Total	2,156,413	668,925	76,995	489,427	102,503	1,487,488

Credit risk exposure by business segment and collateral December 2015

in HUF million	Credit risk exposure	Collateral and other credit risk mitigation				Credit risk exposure net of collateral
		Collateral total	Guarantees	Real estate	Other	
Local Retail	792,172	458,851	2,807	442,359	13,685	333,321
Local Corporate	169,028	72,983	6,084	25,116	41,782	96,045
Group Corporate Centre	10	-	-	-	-	10
Group Large Corporate	202,699	78,506	70,270	2,413	5,823	124,193
Local Real Estate	173,764	49,781	7	46,989	2,786	123,983
Group Markets	689,117	760	0	541	220	688,357
Total	2,026,790	660,882	79,169	517,417	64,296	1,365,909

The major types of collateral are mortgages on residential and commercial real estate, as well as guarantees. Among the other types of collaterals, financial collateral is the most common. The value of collateral is capped at the amount of the underlying outstanding credit exposure in the table above.

Credit risk exposure past due and not covered by specific provisions by Basel III exposure class and collateralisation December 2016

in HUF million	Credit risk exposure past due					
	Total	Thereof 1-30 days past due	Thereof 31-60 days past due	Thereof 61-90 days past due	Thereof 91-180 days past due	Thereof more than 180 days past due
Loans and receivables to credit institutions	21	-	-	-	-	21
Loans and receivables to customers	67,134	49,252	7,572	2,207	299	7,805
Total	67,156	49,252	7,572	2,207	299	7,826

35.7. Market risk

Definition and overview

Market risk is the risk of loss that may arise due to adverse changes in market prices where the parameters are derived from. At Erste Hungary market risk is divided into interest rate risk, currency risk, equity risk, commodity risk and volatility risk. This might concern both, trading as well as banking book positions. Commodity risk has no significant effect on Erste Hungary's financial position as all relevant positions are back to back hedged.

Employed methods and instruments

Value at risk

At the Bank and its subsidiaries potential losses arising from market movements are assessed by using a group standard "Value-at-Risk" model. The calculation is done according to the method of historic simulation with unilateral confidence level of 99 percent, a holding period of one day and a simulation period of two years. Value-at-Risk describes the maximum expected loss at a predefined probability – the confidence level – within a certain holding period of the positions under normal market conditions.

Back testing is used to constantly monitor the validity of the statistical methods. This process is conducted with a one-day delay to monitor if the model projections regarding losses have actually materialized. At a confidence level of 99 percent the actual loss on a single day should exceed the Value-at-Risk statistically only twice or thrice a year (i.e. 1 percent of 250 workdays).

This shows one of the limitations of the Value-at-Risk approach: on the one hand, the confidence level is limited to 99 percent; on the other hand, the model takes into account only those market scenarios observed respectively within the simulation period of two years, and calculates the Value-at-Risk for the current position of the Bank on this basis. In order to investigate any extreme market situation beyond this, stress tests are conducted. These events include mainly market movements of low probability.

Stress test

In order to investigate any extreme market situations beyond this, stress tests are conducted at Erste Hungary. These events include mainly market movements of low probability.

The stress tests are carried out according to a methodology laid down by the Supervision. Standard scenarios are calculated in which the individual market factors are exposed to extreme movements. These include parallel shifts and twist of the particular yield curves and shock movements of exchange rates. Tests are carried out for both trading and banking book positions.

Present value of a basis point

Interest rate risk can also be measured by the extent of the sensitivity of portfolio value to changes in interest rate. This method is called "Present Value of a Basis Point" (PVBP for short) analysis.

Each interest rate relevant position is assigned to specified buckets depending on their remaining maturity till repricing. The buckets range between 1-month and 30-year time intervals. Then the repricing gap structure of the Bank is structured per currency. Some currencies of similar characteristics are then bundled together to form currency groups.

In each bucket PVBP is the sum of the basis point sensitivity of all positions within the bucket. PVBP exposure of a given currency is calculated in the following way:

$$\text{Max}[\text{sum of positive sensitivities}; \text{abs}(\text{sum of negative sensitivities})].$$

This results in a very conservative approach, because in the case of a yield curve shock this method focuses only on the potential losses and does not calculate with the counterbalancing effect of those buckets that contain positions with the opposite direction of the shock.

A limit framework was introduced to control the exposure to interest rate risk for currency groups and also on a total level.

PVBP limits for each currency group were approved by both Market Risk Committee of Erste Group and by ALCO of the Bank. The limit monitoring is performed by the Counterparty and Market Risk Department on a daily bases.

Methods and instruments of risk mitigation

At Erste Hungary, market risks are controlled in the trading book by setting several layers of limits. The overall limit on the basis of Value-at-Risk for the trading book is approved by the ALCO. This overall limit is broken down and assigned to positions prone to currency and interest rate risks respectively.

Additionally, sensitivity limits are assigned to interest rate risk as a second limit layer to the Value-at-Risk limits. Currency risk is further restrained by nominal limits per currency/ currency group.

Limit compliance is verified at two levels: by the appropriate local decentralised risk management unit and by Group Market & Liquidity Risk Management. The monitoring of the limits is done within the course of the trading day based on sensitivities. This can also be carried out by individual traders or chief traders on an ad hoc basis.

The Value-at-Risk is calculated every day at the Group level and made available to the individual trading units as well as to the superior management levels all the way up to the management board.

Within the course of the calculation, the trading book positions are valued independently of trading. This means that, on the one hand, the market data is collected by risk controlling itself, and on the other, that the valuation procedures and models are developed and validated independently of the trading units.

Apart from the trading book positions, once a month, the banking book positions are also subjected to a value-at-risk analysis. In this manner, the total value-at-risk is determined. The result of this calculation is presented in the monthly market risk report that is made available.

Analysis of market risk

Value at Risk of banking book and trading book

The following tables show the VaR amounts as of 31 December, 2016 and 2015 at 99% confidence level, with a holding period of one day:

2016 in HUF million	Total	Interest	Currency	Price
Erste Hungary	325	325	2	-
Banking book	333	333	-	-
Trading book	23	24	2	-

2015 in HUF million	Total	Interest	Currency	Price
Erste Hungary	1,226	1,228	3	1
Banking book	1,250	1,250	-	-
Trading book	56	56	3	1

Due to correlations among various factors total amounts are not a straight summation of partial figures. "Price" includes equity risk.

The sensitivity of the banking book decreased significantly due to the structural change in banking book positions and the lower yield environment. The former one contributed to the improvement more significantly: Erste Bank Hungary purchased higher volume government bonds with long-term maturity in 2016 due to the changed monetary policy instrument that immunized the sensitivity of the demand deposits that have a long modelled maturity.

Interest rate risk of banking book

Interest rate risk is the risk of adverse change in the fair value of financial instruments caused by movement in market interest rates. This type of risk arises when mismatches exist between assets and liabilities (including off-balance-sheet items) in respect of their maturities or of the timing of interest rate adjustments.

In order to identify interest rate risk, all financial instruments, including transactions not recognised in the Statement of Financial Position, are grouped into maturity bands based on their remaining term to maturity or term to an interest rate adjustment.

Exchange rate risk

The bank is exposed to the several types of exchange rate-related risks.

Risk from open currency position

Risk from open currency positions is the exchange rate-related risk that derives from the mismatch between assets and liabilities, or from currency-related financial derivatives. These risks might originate from customer-related operations or proprietary trading and are monitored and managed on daily basis. Foreign currency exposure is subject to regulatory and internal limits.

The following tables show the exchange rate open positions (on-balance and off-balance items) of Erste Hungary as of the dates indicated, respectively.

Exchange rate open positions

in HUF million	2015	2016
EUR	2,135	324
CHF	(1,040)	(3,482)
USD	(1)	2,170
JPY	(71)	(13)
Other	113	275

Hedging

Banking book market risk management consists of optimizing Erste Hungary's risk position by finding the proper trade-off between the economic value of the Statement of Financial position and forecasted earnings. Decisions are based on the Statement of Financial Position development, the economic environment, competitive landscape, fair value of risk, effect on net interest income and appropriate liquidity position. The steering body responsible for interest rate risk management is the ALCO. The ALM submits proposals for actions to steer the interest rate risk to the ALCO and implements ALCO's decisions.

In order to achieve the goals of risk management, hedging activities focus on the two main control variables: net interest income and market value of equity risk. In a broader sense, hedging means an economic activity that mitigates risk, but does not necessarily qualify for IFRS hedge accounting. Erste Hungary manages interest rate risk of the banking book by optimizing on-balance and off-balance positions, and applies hedge accounting to minimize profit and loss volatility. The hedging items are mark-to-market, but the corresponding hedged portfolio is not, and this mismatch causes inconsistency. By applying hedge accounting, market value change of hedging derivatives is booked into equity, ensuring a true and fair view. In 2016 Erste Hungary had no hedge accounting related derivatives.

35.8. Liquidity risk

Definition and overview

The liquidity risk is defined in Erste Hungary in line with the principles set by the Basel Committee on Banking Supervision. Accordingly, a distinction is made between market liquidity risk, which is the risk that the Group entities cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption, and funding liquidity risk, which is the risk that the banks in the Group will not be able to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting either daily operations or the financial condition of the Group members.

Funding liquidity risk is further divided into insolvency risk and structural liquidity risk. The former is the short-term risk that current or future payment obligations cannot be met in full, on time in an economically justified way, while structural liquidity risk is the long-term risk of losses due to a change in the Erste Hungary's own refinancing cost or spread.

Liquidity risk management and measurement is separated within the Bank, reporting and monitoring is done by Risk Management Department, whereas strategic liquidity risk management is the responsibility of Asset Liability Management. This breakdown is compliant with the standards of Erste Group.

Employed methods and instruments

The maturity profile of short-term funding on a currency level has been monitored on a detailed basis to ensure that they have been within the short-term liquidity limits. The short-term liquidity position is monitored on a daily basis. As the primary funding source for Erste Hungary is Erste Group, the share of short-term funding is relatively low. Erste Hungary is particularly focusing on the net cash outflow projection and its coverage by collateral. The focus was set on to ensure a stable amount of central bank eligible collateral in Erste Hungary.

Erste Hungary steers long-term (structural) liquidity risk through a multiple scenario approach. Dynamic aspects of the renewal of existing Statement of Financial position items are incorporated through certain set of assumptions describing the going concern situation besides crisis situations. Similarly, the modelling of customer business is adjusted according to the respective scenario. The purpose of the analysis is to determine the ability of Erste Hungary to withstand distressed situations before they actually occur. Additionally, the traditional liquidity gaps (depicting the going concern maturity mismatches on a currency level) are reported and monitored regularly. Erste Hungary's fund transfer pricing (FTP) system also proved to be an efficient steering tool for structural liquidity risk management.

Methods and instruments of risk mitigation

General standards of liquidity risk controlling and management (standards, limits and analysis) have been defined and are continuously reviewed and improved by Erste Hungary.

Besides regulatory ratios (DMM- (Foreign Funding Adequacy Ratio), (DEM) - Foreign Currency Equilibrium Ratio), LCR (Liquidity Coverage Ratio), NSFR (Net Stable Funding Ratio) short- and long-term liquidity risks are respectively limited by a survival period analysis measurement taking currencies into account. Limit breaches are reported to ALCO. Another important channel for steering the liquidity risk within Erste Hungary is the above mentioned FTP system and prices of intra-group funding. As the process of planning of funding needs provides important data for liquidity management, a detailed overview of funding needs is prepared for the planning horizon across Erste Hungary on quarterly basis.

The Contingency Funding Plan ensures the necessary coordination of all involved parties in the liquidity management process in case of crisis and it is reviewed on a regular basis. The contingency plans of the subsidiaries are coordinated as part of the plan for the Erste Hungary.

Analysis of liquidity risk

Liquidity gap

The long-term liquidity position is managed using liquidity gaps, on the basis of expected cash flows. This liquidity position is calculated for each currency with material volume and based on the assumption of ordinary business activity.

The table shows contractual payments of principal - as they fall due at maturity or according to the amortization schedule. For products without contractual maturities (like demand deposits and overdrafts), modelled principal cash flows are assumed. The modelling relies on statistical analysis of historical volumes for such products.

2016 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
On-Balance Liquidity GAP	116,490	(168,968)	20,838	31,641
Off-Balance Liquidity GAP	1,364	(1,238)	4,846	915

2015 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
On-Balance Liquidity GAP	(36,135)	(99,436)	189,156	(53,586)
Off-Balance Liquidity GAP	(5,179)	(6,104)	1,011	(127)

Derivative financial instruments are excluded from the on-balance sheet category. The off-balance sheet category contains derivative instruments. The table is based on static modelling and no renewals are included.

An excess of assets over liabilities is disclosed with a positive algebraic sign, while an excess of liabilities over assets is disclosed with a negative algebraic sign.

Liquidity buffer

Erste Hungary holds securities eligible at central banks to manage liquidity risk (free collateral). Maturities of contractual (principal only), non-discounted cash flows of these financial assets are shown in the following table:

2016 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
Eligible securities	1,344	54,148	459,155	145,668

2015 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
Eligible securities	5,678	63,533	224,593	7,032

Financial liabilities

Maturities of contractual (principal and interest), non-discounted cash flows of financial liabilities were as follows:

Subordinated liabilities

in HUF million	2015	2016
Deposits from banks	426,805	213,655
subordinated	128,774	50,599
non subordinated	298,031	163,056
Debt securities issued	23,883	38,403
subordinated	3,514	3,779
non subordinated	20,369	34,624

Non-derivative liabilities

2016 in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
Non-derivative liabilities						
Deposits from banks	163,056	168,190	(19,475)	41,966	83,841	61,857
Deposits from customers	1,419,097	1,424,795	1,100,088	214,387	84,036	26,284
Debt securities issued	24,481	26,752	-	536	26,217	-
Financial liabilities designated at fair value through profit or loss	38,403	41,772	2,357	8,572	27,349	3,494
Subordinated liabilities	50,599	60,494	-	2,106	58,388	-
Other liabilities	32,429	32,429	16,942	15,302	53	133
Total	1,728,065	1,753,273	1,100,433	283,883	274,802	94,156

2015 in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
Non-derivative liabilities						
Deposits from banks	298,031	301,410	172,181	30,475	73,766	24,987
Deposits from customers	1,262,093	1,273,763	836,490	339,955	71,800	25,518
Debt securities issued	20,369	21,327	1,143	8,899	11,285	-
Subordinated liabilities	132,288	168,476	-	5,981	24,883	137,612
Other liabilities	19,754	19,754	9,833	8,861	1,060	-
Total	1,732,535	1,784,730	1,019,647	394,171	182,794	188,117

2016 in HUF million	Carrying amount	< 1 month	1-12 months	1-5 years	> 5 years
Contingent liabilities					
Guarantees	23,855	23,855	-	-	-
Committed credit lines -irrevocable	165,989	165,989	-	-	-

2015 in HUF million	Carrying amount	< 1 month	1-12 months	1-5 years	> 5 years
Contingent liabilities					
Guarantees	28,299	28,299	-	-	-
Committed credit lines -irrevocable	121,898	121,826	72	-	-

2016 in HUF million	< 1 week	1 week-1 month	1-3 months	3-6 months	6-12 months
Cash, excess reserve	82 978	-	-	-	-
Liquid assets	627 248	(59 320)	(23 712)	(4 525)	(18 212)
Other central bank eligible assets	526	-	-	-	-
thereof retained covered bonds	526	-	-	-	-
thereof credit claims	-	-	-	-	-
Counterbalancing capacity	710 751	(59 320)	(23 712)	(4 525)	(18 212)

Counterbalancing capacity					
2015 in HUF million	< 1 week	1 week-1 month	1-3 months	3-6 months	6-12 months
Cash, excess reserve	95,911	(30,609)	-	-	-
Liquid assets	305,160	8,984	1,678	-	-
Other central bank eligible assets	549	-	-	-	-
thereof retained covered bonds	549	-	-	-	-
thereof credit claims	-	-	-	-	-
Counterbalancing capacity	401,620	(21,625)	1,678	-	-

Repricing gap

The following repricing gap figures do not contain past due loans.

2016 in HUF million	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing gap in EUR positions	35,081	(28,067)	6,716	(5,652)
Repricing gap in HUF positions	(239,022)	2,142	55,093	436,572
Repricing gap in CHF positions	6,315	(3,284)	12,105	-
Repricing gap in USD positions	6,453	2,326	8,195	122

2015 in HUF million	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing gap in EUR positions	6,858	(2,362)	(2,798)	(949)
Repricing gap in HUF positions	(238,513)	58,316	14,549	208,019
Repricing gap in CHF positions	32,938	(50,348)	8,500	-

Maturity of contractual cash flow of derivatives

Derivatives are shown net.

2016 in HUF million	Total contractual cash-flows	< 1 month	1-12 months	1-5 years	> 5 years
HUF	(256,747)	(141,002)	(124,578)	4,716	4,116
EUR	249,190	125,783	126,299	130	(3,022)
CHF	5,614	6,139	(347)	-	(179)
USD	1,420	2,616	(1,195)	-	-
Other	6,411	7,828	(1,417)	-	-

2015 in HUF million	Total contractual cash-flows	< 1 month	1-12 months	1-5 years	> 5 years
HUF	(162,927)	(124,364)	(39,712)	1,147	1
EUR	162,752	19,896	143,299	(335)	(109)
CHF	(23,332)	97,747	(121,058)	-	(20)
USD	13,108	1,542	11,366	199	0
Other	-	-	-	-	-

35.9. Operational risk

Definition and overview

In line with the regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and the directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms respectively, Erste Bank Hungary defines operational risk as ‘the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risks’. Both quantitative and qualitative methods are used to identify operational risks. Consistent with international practice, the responsibility for managing operational risk rests with the line management.

Employed methods and instruments

The quantitative measurement methods are based on internal loss experience data, which is collected according to the standard methodology of Erste Group Bank AG and entered in the central loss data collection system. Additionally, in order to take into account losses that have not occurred in the past but are nonetheless possible, scenarios and external data are also used.

Erste Bank Hungary received regulatory approval for the AMA approach in 2009. AMA is a sophisticated approach to measure operational risk. Pursuant to AMA, the required capital is calculated using an internal VaR model, taking into account internal data, external data, scenario analysis, business environment and internal risk control factors. The operational risk capital calculation is centralized; Erste Group Bank AG calculates a group-level capital requirement, which is allocated for the subsidiaries

Methods and instruments of risk mitigation

In addition to quantitative methods, qualitative methods are also used to determine operational risk, such as risk assessment surveys (Risk Control and Self-Assessments). The results of and suggestions for risk control in these surveys taken by experts are reported to line management and thus help to reduce operational risks. Erste Bank Hungary also reviews certain Key Risk Indicators periodically to ensure early detection of changes in risk potential that may lead to losses.

Erste Bank Hungary uses a group-wide insurance programme, which, since its establishment in 2004, has reduced the cost of meeting Erste Bank Hungary’s traditional property insurance needs and made it possible to buy additional insurance for previously uninsured banking-specific risks. This programme uses a captive reinsurance entity as vehicle to share losses within the group and access the external market.

The quantitative and qualitative methods used, together with the risk mitigation measures described above form the operational risk framework of Erste Bank Hungary. Information on operational risk is periodically communicated to the Management Board via various reports, including the quarterly top management report, which includes recent loss history, loss development, qualitative information from risk assessments and key risk indicators as well as the operational VaR for Erste Bank Hungary.

The Operational Risk Management Committee, which is responsible for the mitigation of operational risk exposure, meets on a quarterly basis. The purpose of this Committee is to discuss all operational risk management related topics. The committee includes key decision makers from the bank

Business Continuity Management

In case of unforeseeable events, such as a crisis, Business Continuity Plans (“BCPs”) have been defined by Erste Bank Hungary. The BCPs include a predefined set of tools as well as processes, resources, roles and responsibilities, with the goal of responding immediately and effectively to any such crisis.

Distribution of operational risk events

Detailed below are the types of operational risk event sources as defined by the Basel II Capital Accord. The event type categories are as follows

Internal fraud:

Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity or discrimination events that involve at least one internal party.

External fraud:

Losses due to acts by a third party of a type intended to defraud, misappropriate property or circumvent the law, by a third party.

Employment practices and workplace safety:

Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims or from diversity or discrimination events.

Clients, products and business practices:

Losses arising from unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements) or from the nature or design of a product.

Damage to physical assets:

Losses arising from loss of or damage to physical assets caused by natural disaster or other events.

Business disruption and system failures:

Losses arising from disruption of business or system failures.

Execution, delivery and process management:

Losses from failed transaction processing or process management. Losses pertaining to relationships with trading counterparties and vendors or suppliers.

35.10 Real estate risk

The recent unprecedented recession has resulted in major long term distress across the real estate market. Erste Hungary is facing the challenge of changing economic situation as well, holding real estates that served previously as collateral for loans. The selling prospective of real estates seriously declined in the past few years, implying a new aspect of risk to manage, the real estate risk. The regular yearly valuations made by independent experts, having deep understanding of the market and holding experiences in the kind of properties of Erste Hungary's portfolio is the key element of managing risk related to fair value of the portfolio, kept primarily in 'Other assets'. Beside that Erste Hungary are making steps to minimise losses by earning rental income. In case of certain criteria are presented in accounting policies, real estate are reclassified into 'Investment property'.

36) Fair value of financial and non-financial instruments

The following is a description of how fair values are determined for financial instruments that are recorded at fair value using valuation techniques. These incorporate Erste Hungary's estimate of assumptions that a market participant would make when valuing the instruments.

Derivatives

Derivative products valued using a valuation technique with market-observable inputs are mainly interest rate swaps and options, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including foreign exchange spot and forward rates and interest rate curves.

Financial investments – available for sale

Available for sale financial assets valued using valuation techniques or pricing models primarily consist of debt securities. These assets are valued using models that apply market-observable data.

Other trading assets

Other trading assets valued using a valuation technique consists of certain debt securities. Erste Hungary values the securities using discounted cash flow valuation models which incorporate observable data. Observable inputs include assumptions regarding current rates of interest and broker statements.

Cash and balances with central banks

This line includes financial instruments for which fair value is determined on the basis of quoted market prices.

Loans and receivables to customers and credit institutions

The fair value of loans and receivables to customers and credit institutions has been calculated by discounting future cash flows while taking into consideration interest effects. Loans and receivables were grouped into homogeneous portfolios based on maturity.

Liabilities without contractual maturities

For liabilities without contractual maturities, the carrying amount represents its fair value. The fair value of the other liabilities is estimated by taking into consideration the actual interest rate environment and changes in own credit risk.

Erste Hungary uses the following hierarchy for disclosures about the measurement of the fair value of financial instruments, reflecting the importance of individual inputs to the process of determining the fair value of financial instruments:

Level 1: Financial instruments, which are valued based on quoted (unadjusted) prices in an active market for such assets or liabilities. This includes financial instruments, which are traded in sufficient quantity on an exchange, debt instruments quoted by several market participants with sufficient depth or liquid derivatives, which are traded on an exchange.

Level 2: Financial instruments, which are valued based on quoted prices (in non-active markets or in active markets for similar assets or liabilities) and inputs other than quoted prices that are observable. This includes yield curves derived from a liquid underlying or prices from a similar instrument.

Level 3 inputs are non-observable. This includes extrapolation of yield curves or volatilities, and the usage of historical volatilities. The fair value of non-financial instruments not measured at fair value is presented under Level 2 and Level 3.

“Assets held for sale”, containing repossessed vehicles are shown in Level 2. The valuation is based on EUROTAX catalogue, which is a public database, generally accepted as a reference of valuation applied by banks and insurance companies. The reference price is refined by corrections related to observable individual characteristic (i.e. scratches, damages) of the vehicles, based on transactions involving vehicles of similar characteristics.

“Investment property” is presented in Level 3. The key element of the profit generating focused valuation is the observable rental price in the given area. The basic prices are refined by the valuers introducing corrective elements valuing the individual features (i.e. terraces, floor). The valuation is made by independent valuator holding EUFIM qualification (Hungarian qualification system elaborated conforming 45013 EU principle) and experiences in the given location.

In Level 3 ‘Derivatives’ and ‘Financial assets available for sale’ are presented. The unobservable element in Level 3 valuation of ‘Derivatives’ is the credit value adjustment (CVA) and debit value adjustment (DVA) represented the counterparty risk related to derivative deals. Erste Hungary is assessing that alternative risk modelling technique would not leave to materially different result.

‘Financial assets available for sale’ contains VISA Inc. shares of which the Level 3 valuation contains a discount related to a potential earn out payment contingent of a minimum holding period, assessing no alternative valuation technique for.

Financial assets are transferred from Level 1 to Level 2 if they are ceased to be actively traded during the year and fair values were consequently obtained using valuation techniques using observable market inputs. Transfers from Level 3 to Level 2 occur when the market becomes more liquid, which eliminates the need for the preciously required significant unobservable valuation inputs. Transfers into Level 3 reflect changes in market conditions as a result of which instruments become less liquid. There were no transfers during the business year.

The table below details the valuation methods used to determine the fair value of financial instruments measured at fair value:

2016	Quoted market prices in active markets	Marked to model based on observable marked data	Marked to model based on non-observable inputs	Total
in HUF million	Level 1	Level 2	Level 3	
Financial assets -held for trading - Derivatives and derivatives hedge accounting	114	13,662	1,620	15,397
Financial assets –held for trading - Other trading assets	85,493	32,165	0	117,658
Financial assets - available for sale	105,465	30,506	999	136,970
Total assets	191,072	76,333	2,619	270,025
Financial liabilities – held for trading - Derivatives	58	11,280	-	11,337
Financial liabilities – held for trading - Other trading liabilities	1,060	-	-	1,060
Financial liabilities designated at fair value through profit or loss	-	24,481	-	24,481
Total liabilities	1,118	35,761	-	36,879

2015	Quoted market prices in active markets	Marked to model based on observable marked data	Marked to model based on non-observable inputs	Total
in HUF million	Level 1	Level 2	Level 3	
Financial assets -held for trading - Derivatives and derivatives hedge accounting	29	8,989	1,829	10,846
Financial assets - held for trading - Other trading assets	56,206	1,828	-	58,034
Financial assets - available for sale	44,097	39,979	4,696	88,771
Total assets	100,332	50,795	6,524	157,651
Financial liabilities – held for trading - Derivatives	221	20,345	-	20,566
Financial liabilities – held for trading - Other trading liabilities	64	-	-	64
Total liabilities	285	20,345	-	20,630

The table below shows the movement within Level 3 category:

in HUF million	01.01.2016	Purchase	Sale/ Settlement	Gains/Losses in other comprehensive income	Gains/Losses in income statement	Transfer into Level3	Transfer out of Level3	Exchange rate effect	31.12.2016
Financial assets - held for trading	1,829	-	-	-	(247)	479	(401)	(39)	1,620
Derivatives & Derivatives - hedge accounting	1,829	-	-	-	(247)	479	(401)	(39)	1,620
Financial assets - available for sale	4,696	1,309	(4,060)	345	(304)	-	(1,016)	29	999
Financial liabilities held for trading	-	-	-	-	(18)	(101)	119	(0)	(0)

in HUF million	01.01.2015	Purchase	Sale/ Settlement	Gains/Losses in other com- prehensive income	Gains/Losses in income statement	Transfer into Level3	Transfer out of Level3	Exchange rate effect	31.12.2015
Financial assets - held for trading	1,955	-	-	-	(933)	645	-	161	1,829
Derivatives & Derivatives - hedge accounting	1,955	-	-	-	(933)	645	-	161	1,829
Financial assets - available for sale	0	-	-	4,710	-	-	-	(15)	4,696

Financial instruments not measured at fair value

The book value of floating rate loans and advances reflect the market value of the asset based on the assumption of Erste Hungary. For loans and advances other than floating rate, a discounted cash flow model is used based on various assumptions, including current and expected future credit losses, and market rates of interest.

For deposits and unquoted notes issued, a discounted cash flow model is used based on current interest rate yield curves appropriate for the remaining term to maturity.

The following table shows fair values of financial instruments not measured at fair value:

2016 in HUF million	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observ- able market data Level 2	Marked to model based on non- observable inputs Level 3
ASSETS	1,709,449	1,714,422	547,896	4,568	1,166,089
Cash and balances with central bank	106,050	106,050	106,050	-	-
Loans and receivables to credit institutions	145,499	145,624	-	-	145,624
Loans and receivables to customers	1,021,232	1,016,334	-	-	1,016,334
Financial assets - held to maturity	436,668	446,414	441,845	4,568	-
LIABILITIES	1,721,960	1,709,471	-	19,909	1,689,562
Deposits from banks	213,655	205,107	-	-	205,107
Deposits from customers	1,419,097	1,414,033	-	-	1,414,033
Debt securities issued	38,403	38,891	-	15,024	23,868
Subordinated liabilities	50,805	51,440	-	4,885	46,555

2015 in HUF million	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observ- able market data Level 2	Marked to model based on non- observable inputs Level 3
ASSETS	1,687,790	1,709,781	402,665	9,624	1,297,492
Cash and balances with central bank	111,869	111,869	111,869	-	-
Loans and receivables to credit institutions	278,436	278,752	-	-	278,752
Loans and receivables to customers	1,006,602	1,020,408	-	-	1,020,408
Financial assets - held to maturity	294,731	302,599	290,795	9,624	2,180
LIABILITIES	1,712,833	1,717,903	-	24,587	1,693,316
Deposits from banks	298,031	298,963	-	-	298,963
Deposits from customers	1,262,093	1,260,220	-	-	1,260,220
Debt securities issued	20,369	20,831	-	20,035	796
Subordinated liabilities	132,288	137,836	-	4,552	133,284

2016						
in HUF million	Notes	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable market data Level 2	Marked to model based on non-observable inputs Level 3
Assets whose Fair Value is disclosed in the notes		10,620	12,580	0	0	12,580
Investment properties		10,620	12,580	0	0	12,580
Assets whose Fair Value is presented in the Statement of Financial Position		11,338	11,338	0	187	11,150
Assets held for sale (IFRS 5)	21	187	187	0	187	0
Repossessed assets (IAS 2)	22	11,150	11,150	0	0	11,150

2015						
in HUF million	Note	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable market data Level 2	Marked to model based on non-observable inputs Level 3
Assets whose Fair Value is disclosed in the notes		10,926	12,822	-	-	12,822
Investment properties		10,926	12,822	-	-	12,822
Assets whose Fair Value is presented in the Statement of Financial Position		23,819	23,819	-	26	23,794
Assets held for sale (IFRS 5)	21	26	26	-	26	-
Repossessed assets (IAS 2)	22	23,794	23,794	-	-	23,794

37) Financial instruments per category according to IAS 39

2016								
in HUF million		Loans and receivables	Held to maturity	Trading	Available for sale	Financial liabilities designated at fair value through profit or loss	Financial assets and financial liabilities at amortised cost	Total
ASSETS								
Cash and cash balances with central bank		106,050	-	-	-	-	-	106,050
Financial assets held for trading		-	-	133,055	-	-	-	133,055
Derivatives		-	-	15,397	-	-	-	15,397
Other trading assets		-	-	117,658	-	-	-	117,658
Financial assets – available for sale		-	-	-	137,749	-	-	137,749
Financial assets – held to maturity		-	436,668	-	-	-	-	436,668
Loans and receivables to credit institutions		145,499	-	-	-	-	-	145,499
Loans and receivables to customers		1,021,232	-	-	-	-	-	1,021,232
Other assets		-	-	-	-	-	27,486	27,486
Total		1,272,781	436,668	133,055	137,749	-	27,486	2,007,739
LIABILITIES								
Financial liabilities held for trading		-	-	12,398	-	-	-	12,398
Derivatives		-	-	11,337	-	-	-	11,337
Other trading liabilities		-	-	1,060	-	-	-	1,060
Financial liabilities designated at fair value through profit or loss		-	-	-	-	24,481	-	24,481
Debt securities issued		-	-	-	-	24,481	-	24,481
Financial liab. measured at amortised costs		-	-	-	-	-	1,671,155	1,671,155
Deposits from banks		-	-	-	-	-	213,655	213,655
Deposits from customers		-	-	-	-	-	1,419,097	1,419,097
Debt securities issued		-	-	-	-	-	38,403	38,403
Other financial liabilities		-	-	-	-	-	-	-
Other liabilities		-	-	-	-	-	32,429	32,429
Total		-	-	12,398	-	24,481	1,703,584	1,740,463

2015							
in HUF million	Loans and receivables	Held to maturity	Trading	Available for sale	Financial liabilities designated at fair value through profit or loss	Financial assets and financial liabilities at amortised cost	Total
ASSETS							
Cash and cash balances with central bank	111,869	-	-	-	-	-	111,869
Financial assets held for trading	-	-	68,880	-	-	-	68,880
Derivatives	-	-	10,846	-	-	-	10,846
Other trading assets	-	-	58,034	-	-	-	58,034
Financial assets – available for sale	-	-	-	89,555	-	-	89,555
Financial assets – held to maturity	-	294,731	-	-	-	-	294,731
Loans and receivables to credit institutions	278,436	-	-	-	-	-	278,436
Loans and receivables to customers	1,006,602	-	-	-	-	-	1,006,602
Other assets	-	-	-	-	-	40,496	40,496
Total	1,396,907	294,731	68,880	89,555	-	40,496	1,890,569
LIABILITIES							
Financial liabilities held for trading	-	-	20,630	-	-	-	20,630
Derivatives	-	-	20,566	-	-	-	20,566
Other trading liabilities	-	-	64	-	-	-	64
Financial liabilities designated at fair value through profit or loss	-	-	-	-	-	-	-
Debt securities issued	-	-	-	-	-	-	-
Financial liab. measured at amortised costs	-	-	-	-	-	1,712,781	1,712,781
Deposits from banks	-	-	-	-	-	426,805	426,805
Deposits from customers	-	-	-	-	-	1,262,093	1,262,093
Debt securities issued	-	-	-	-	-	23,883	23,883
Other financial liabilities	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	19,754	19,754
Total	-	-	20,630	-	-	1,732,535	1,753,165

38) Audit fees and consultancy fees

The following table contains audit and tax fees charged by the auditors (Ernst & Young) in the fiscal years 2015 and 2016:

in HUF million	2015	2016
	277	408

39) Contingent liabilities

To meet the financial needs of customers, Erste Hungary enters into various irrevocable commitments and contingent liabilities. These consist of financial guarantees, letters of credit and other undrawn commitments to lend. Even though these obligations may not be recognised on the Statement of Financial Position, they do contain credit risk and are therefore part of the overall risk of the Bank.

in HUF million	2015	2016
Irrevocable contingent liabilities	151,492	191,958
Guarantees	28,299	23,855
Committed credit lines -irrevocable	121,898	165,989
Import accreditives	1,295	2,114
Revocable contingent liabilities	72,651	104,358
Committed credit lines - revocable	72,651	104,358
Other contingent liabilities	662	1,290
Legal cases	53	192
Other	609	1,098
Total	224,805	297,606

Related Provision see note 25, page 46.

Legal proceedings

Erste Hungary is involved in legal disputes, most of which have arisen in the course of its ordinary banking business. These proceedings are not expected to have a significant negative impact on the financial position or profitability of the Group.

Foreign currency loan related invalidity lawsuits by consumers against banks, including the Bank, were suspended by the regulations of the 2014 consumer loan laws until the completion of the settlement and refund process towards the customers concerned. While some plaintiffs did not pursue their claims further, the Bank remained a defendant in several of these litigations. Regardless of the settlement, consumers continue to initiate further court cases, creating a level of uncertainty on assessing the potential financial impact in case of adverse adjudications.

The level of uncertainty related to the outcome of these invalidity cases also has been increased by the Hungarian local courts initiating the preliminary ruling of European Court of Justice in several proceedings related to the regulation of the 2014 consumer loan laws. There is an ongoing investigation by the European Court of Justice on EU law compliance of Hungarian national legal environment.

40) Analysis of remaining maturities

The breakdown of remaining maturities of the Bank's financial assets and liabilities are modelled:

in HUF million	2015		2016	
	< 1 year	> 1 year	< 1 year	> 1 year
Cash and cash balances with central bank	111,869	-	106,050	-
Financial assets - held for trading	33,530	35,350	91,965	41,090
Financial assets - available-for-sale	5,764	83,792	5,975	131,774
Financial assets - held to maturity	90,706	204,025	58,330	378,338
Loans and receivables to credit institutions	278,436	-	145,499	-
Loans and receivables to customers	281,318	725,284	253,592	767,640
Property and equipment	-	8,590	-	8,991
Investment properties	-	10,926	-	10,620
Intangible assets	-	13,041	-	18,310
Current tax assets	892	-	1,000	-
Deferred tax assets	-	122	33	-
Non-current assets and disposal groups classified as held for sale	26	-	187	-
Other assets	9,767	30,729	21,898	5,588
TOTAL ASSETS	812,308	1,111,859	684,530	1,362,351
Deposits from banks	200,120	97,911	71,884	91,172
Deposits from customers	721,018	541,075	592,960	826,136
Debt securities issued	9,787	10,582	9,507	28,896
Financial liabilities held for trading	3,891	16,739	8,222	4,176
Financial liabilities designated at fair value through profit or loss	-	-	-	24,481
Provisions	9,038	808	4,663	20,493
Current tax liabilities	13	-	9	-
Deferred tax liabilities	-	874	238	-
Other liabilities	18,694	1,060	32,244	186
Subordinated liabilities	-	132,288	-	50,599
Total equity	-	160,268	-	281,015
attributable to	-	-	-	-
non-controlling interests	-	-	-	-
owners of the parent	-	160,268	-	281,015
TOTAL LIABILITIES	962,561	961,605	719,727	1,327,154

41) Own funds and capital requirement according to Hungarian regulatory requirements

The primary objectives of the Erste Hungary's capital management policy are to ensure that Erste Hungary complies with externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholder value.

Erste Hungary manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, Erste Hungary may adjust the amount of dividend payment to shareholders or return capital to shareholders. No changes have been made to the objectives, policies and processes from the previous years.

The calculation is made in accordance with Hungarian regulatory requirements, conform to EU regulation, and based on consolidated IFRS.

During 2016 and 2015 the Bank and Erste Hungary had complied in full with all its externally imposed capital requirements.

in HUF million	2015	2016
Tier 1 capital before deductions	160,229	237,633
Deductions from the Tier 1 capital (-)	15,814	20,784
Tier 1 capital after deductions	144,415	217,154
Tier 2 capital	136,882	55,813
Deductions from the Tier 2 capital (-)	473	-
Total qualifying own funds	280,823	272,968
Risk weighted assets (base for credit risk)	1,107,628	1,118,618
Capital requirement for credit risk	88,611	89,489
thereof IRB approach	77,569	79,050
thereof standardized approach	11,042	10,439
Capital requirement for market risk	1,442	2,803
thereof calculated with simple approach	1,442	2,803
thereof from debt instruments	1,074	1,067
thereof from capital instruments	8	4
thereof open fx-positions	355	1,732
thereof commodity risk	5	-
Other capital requirements for credit valuation adjustment	210	551
Pillar 2 requirement	0	0
Capital requirement for operational risk	13,691	30,605
Total base for capital requirement	1,299,408	1,543,096
Total capital requirement	103,953	123,448
Tier 1 ratio	11.11%	14.07%
Solvency ratio	21.61%	17.69%
Solvency ratio after pillar 2 deduction	21.61%	17.69%
Legal minimum solvency ratio set by HFSA for Erste Hungary	16.53%	15.20%

42) Events after the balance sheet date

Purchase of Citibank's Hungarian retail banking and cards business

In February 2017 the Bank completed one of the largest bank portfolio acquisitions in the last 10 years by acquiring the Hungarian consumer banking business of Citibank Europe plc. The transaction resulted in Erste Bank Hungary having the second largest retail customer portfolio in Hungary. As part of the acquisition process, making headway in asset management, the Bank launched the new Erste World segment in March 2016, expanding its mass-affluent and private banking services.

Conforming to the scale and complexity of the deal, the acquisition contract provides a 90 day post-migration period for the parties in order to calculate and finalise the purchase price. The end of this period falls after the issuance date of the financial statements of the business year 2016.

The transaction includes the takeover of the following financial instruments, migrated into the Bank as of 4 February 2017, subject of further reconciliation till May 2017 as prescribed by the contract:

	number of accounts	amount in billion forint
credit cards (pieces w/o sub card)	106,000	33.8
loans	18,800	16.8
deposits	88,600	160
securities under management	7,000	135.5

Based on the preliminary purchase price data and the migrated amounts before the post-migration finalisation the bank recognised intangible assets as well, such as goodwill (0.76 billion forint) and customer relationship (6.9 billion forint).

Although the above mentioned post-migration period including the purchase price allocation has not yet ended, the Bank does not expect material differences in the fair value of the migrated instruments.

Curia decision

By the decision of the Hungarian Competition Authority of 19 November 2013 11 leading Hungarian banks were fined for harmonised activities in setting their practices in the case of the "Endpayment" scheme (details of the scheme see in point C) in the period of 15 September 2011 - 30 January 2012. The decision was appealed and the legal case continued at Supreme Court (Curia). By the Curia decision due to the imperfection of the legal procedure the original decision is nailed, the amount of the fine was paid back to the Bank and new procedure is ordered. Conforming to the decision the Bank allocated legal provision in 2017, in the amount of the original fine of 1.7 billion HUF.

43) Details of the companies wholly or partly-owned by Erste Bank Hungary Zrt. at 31 December 2016

Company name	Interest of Erste Bank Hungary in % - directly or indirectly at 31.12.2015	Interest of Erste Bank Hungary in % - directly or indirectly at 31.12.2016
Subsidiaries:		
Erste Befektetési Zrt.	100%	100%
Erste Leasing Bérlet Szolgáltató Kft.	100%	0%
Erste Lakáslízing Zrt.	100%	100%
Erste Ingatlan Kft.	100%	100%
Sió Ingatlan Invest Kft.	100%	100%
Erste Lakástakarék Zrt.	100%	100%
Erste IN-FORG Kft.	100%	100%
Collat-reál Kft.	100%	100%
Erste Jelzálogbank Zrt.	100%	100%
Other investments:		
Erste Vienna Insurance Group Zrt.	5%	5%
Budapest Stock Exchange Ltd.	0%	2,3%
Garantiqa Hitelgarancia Zrt.	2.1%	2.1%
Kisvállalkozás-fejlesztési Pénzügyi Zrt.	1.1%	1.1%
MasterCard Incorporated (USD)	0.01%	0.01%
VISA Europe Limited (EUR)	0.0067%	0%
VISA Incorporated (USD)	0.0015%	0,002%



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Business Report

for

the Consolidated Financial Statement of Erste Bank Hungary Zrt.
in accordance with International Financial Reporting Standards as adopted by the European Union
Concerning Year 2016

Budapest, 7 April 2017

The Consolidated Financial Statements and Business Report for 2016 of ERSTE Bank Hungary Zrt. and its subsidiaries ("Erste Hungary") contains primarily a summary of its banking activities, supplemented with the information that affected Erste Hungary's operation for the purposes of the evaluation of its business operation.

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BUSINESS ENVIRONMENT, OBJECTIVES AND STRATEGY OF THE GROUP

Based on data adjusted for seasonal and calendar effects, the performance of the Hungarian economy grew by 2.0 per cent in the first three quarters of 2016, compared to the 3.1 per cent increase in the previous year. Growth in Q3 means an increase of 2.2 per cent in performance as compared with the same period of the previous year, which is due primarily to the contribution of market services and agriculture. Till the third quarter of 2016 the performance of agriculture became 21 per cent higher, while the performance of construction decreased by 12 per cent. As regards year 2016 as a whole, based on preliminary calculations the performance of the economy grew by 2.0 per cent.

With regards to internal consumption, positive trend continued in 2016: in the 3rd quarter of 2016 retail consumption increased by 3.8 per cent, which is considered as a significant growth. The volume of investments in the national economy was 9.3 per cent lower in the 3rd quarter of 2016 than in the same period of the previous year. The volume of investments changed differently in the case of enterprises and budgetary units and entities: it increased among enterprises (+3.3 per cent), while it was down by 57 per cent in the case of budgetary units and entities – due to the lower volume of developments financed from EU funds – compared to one year earlier. In the first three quarters of 2016, investment fell by 14 per cent compared to the previous year.

By the 3rd quarter of 2016, the total foreign trade export volume of the country grew by 4.6 per cent as compared with the same period of year 2015. Both exports of goods and services slowed down in the third quarter compared to the first half of the year. Unemployment rate is moving on a decreasing path and has been steadily below 10 per cent since the second half of 2013: in the period between October and December 2016 unemployment fell by 1.7 percentage points to 4.4 per cent, mostly as a result of the government's public works programmes.

In December 2016, consumer prices were 1.8% higher on average than a year earlier. The highest price rises in this period were measured for other goods including motor fuels as well as for alcoholic beverages and tobacco out of the main groups of consumption. In 2016 as a whole, consumer prices rose by 0.4 per cent on average compared to the previous year. The highest price rise was recorded for alcoholic beverages and tobacco and for services, while consumers paid significantly less for other goods.

The interest rate cutting cycle of the National Bank of Hungary has continued in March 2016, as a result, after a three-month decrease of 15 percentage points, in May 2016 the central bank decreased the benchmark rate to a historically low level of 0.9 per cent, while pushed interbank rates even much below, to 0.37 per cent.

Tight labor market conditions, coupled with increases in real wages, suggest that household consumption is likely to be the main driver of economic growth in 2017. In addition, investments should somewhat rebound, and may again contribute positively to economic growth, due to the expected acceleration in the utilization of EU funds. Moreover, the ongoing loose monetary conditions should help both consumption and investments. On the other hand, the fragile recovery of the euro area as well as risks related to Brexit and the presidency of Trump in the US may pose risks to trade developments.

In 2016, retail loan portfolio, as a balance of disbursements and repayments, have not changed compared to the end of the previous year which is a result of significant increase in new disbursements. Particularly housing loan volume increased supported by home purchase state subsidy for families (CSOK), but unsecured consumer loans increased as well. During 2016, consumer loan conditions softened, while housing loan conditions remained unchanged except for Q2. In 2016, total corporate loan volume increased in a pace unexperienced since the crisis. Loan portfolio growth was driven by volume growth of HUF loans. Beside HUF loans of the Funding for Growth Scheme, market based HUF lending also significantly increased. SME segment lending growth was realized with increasing demand and easing loan supply constraints. Banks fulfilled 150% of Market based Lending Scheme (MLS) commitments made in the beginning of 2016, out of which 15 banks substantially overachieved. On the liability side, despite the result of the squeezing out effect of the low interest rate environment and alternative investment opportunities, the retail deposit portfolio of the sector slightly increased, while due to the savings of the corporate and other segments, the total deposit portfolio increased more significantly.

The Hungarian banking sector realized record profit in 2016, mainly due to risk provision releases after loan portfolio improvement and gains on Visa-share sale. In addition to the positive one-off items, the interest rate environment is getting worse for the banks, negatively impacting operating income generating capability. Therefore, it is unlikely to repeat the result of 2016 next year.

The Memorandum of Understanding, signed by the Hungarian Government and the European Bank for Reconstruction and Development (EBRD) in February 2015 about the banking tax reduction from 2016, meant a significantly positive change to the banking sector, however financial transaction duty and free cash withdrawal are going to remain in effect. Additionally

bankruptcy of the brokerage companies in the first half of 2015 mean extra burdens to the financial sector as compensation of customers is borne by the financial institutions.

Looking ahead to the coming years, changes in legislation and government measures have a significant impact on profits: the settlement and FX-conversions of remaining foreign currency household loans, and the increase in the fees to be paid to the National Deposit Insurance Fund (OBA) and the Investor Protection Fund (BEVA) have a negative effect on the banking sector's income, while the reduction of the bank levy, the allowance that can be received in the bank levy and the termination of the exchange rate cap scheme have a positive impact.

Among government measures, the National Asset Management Company set up in 2011 in the scope of the Home Protection Action Plan in order to help foreign currency mortgage borrowers should also be mentioned. The company completed about 28,000 sales transactions during 2012-2015. Its target to purchase 25,000 real estates by 2015 has been extended to 35,000 by the end of 2017, but further extension is probable. Additional government measure was the introduction of personal bankruptcy, which presents an ordered option for restructuring with tight conditions for debtors.

In the changing market environment Erste Hungary focuses on the growth potentials, and unlike some of its competitors – which chose to exit or significantly limit their operation – plans to remain in a significant player both in retail and corporate segments in Hungary. In February 2015, together with the Hungarian Government and EBRD, the Bank signed the Memorandum of Understanding, based on what in August 2016 Corvinus Nemzetközi Befektetési Zrt. (representing the Hungarian State) and EBRD acquired minority stakes of 15 per cent each in Erste Bank Hungary Zrt.. In line with the Memorandum of Understanding, the Hungarian Government reduced Hungary's banking tax in two phases, from which the entire Hungarian banking sector will benefit. Additionally Erste Hungary has completed one of the largest Hungarian bank acquisitions in the last years in February 2017 by acquiring the Hungarian consumer banking business of Citibank Europe plc.. As part of the acquisition process, making headway in asset management, Erste Hungary launched the new Erste World segment in March 2016, expanding its mass-affluent and private banking services. In 2015 Erste Hungary established its new mortgage bank, Erste Jelzálogbank Zrt and as an important milestone in the first half of 2016 the mortgage bank was granted all licenses necessary to its operation and in 2016 two bond issuance programs already occurred. Furthermore, the Bank has acquired a minority shareholding of 2.3% in the Budapest Stock Exchange (BSE) from ING Bank and launched a new MobilBank application for iOS and Android devices. In Q3 2016 the Bank sold a substantial part of its non-performing retail mortgage loan portfolio to a debt collection agency, and thus decreasing both the retail and total NPL ratio to single digit.

The strategic goal of Erste Hungary is to continue its operation as an important player of the Hungarian banking market with the support of a well-balanced corporate business, a reinforced risk management, efficient operations and a continuously improving service quality, focusing on retail customers who regard the Bank as the number one financial institution.

Erste Hungary provides a wide range of financial products and services to its customers throughout their whole financial lifecycle: deposits, investments products, loans, advisory services and leasing products. Keeping its position as a leading retail lending institution, together with the acquisition of Citibank's retail business line Erste Hungary wishes to become market leader in the private banking and credit card business lines, as well as in terms of electronic channels and innovative solutions, and furthermore lays great emphasis on retaining its solid share in the market of savings. In order to keep its market position, the bank offers tailored financial services through its simplified and segmentation-based product portfolio, and wishes to expand its existing customer base with the improvement of service quality and innovative banking solutions. Apart from its core banking activities, Erste Hungary plays an important role in the market of products having a significant growth potential such as investment and building society services. Erste Lakástakarék Zrt, (Building Society) after 4 years of deposit collection, in January 2016 started its loan disbursement operation and could become a significant pillar of new loan disbursement in the following years.

The corporate business line still offers all-inclusive banking services for all segments, anticipating the biggest growth in the midmarket segment, where the goal is the development of transaction services and the maintenance of nation-wide presence. In line with the market trends, corporate lending takes place primarily via subsidised structures, and besides credit products the bank offers a wide range of transaction services and other solutions to its corporate customers.

Change in the group's form of operation

The Bank's form of operation did not change during the business year of 2016. The change in the corporate form of the Bank to private limited company (Zrt.) was registered by the Court of Registration as of 3 January 2011. The full name of the Bank is Erste Bank Hungary Zártkörűen Működő Részvénytársaság.

In June 20, 2016 Corvinus Nemzetközi Befektetési Zrt. (representing the Hungarian State) and the European Bank for Reconstruction and Development (EBRD) signed the contractual framework with Erste Group Bank AG to acquire minority equity

stakes of 15 per cent each in Erste Bank Hungary Zrt. After the regulatory approvals regarding the transaction and completion of other conditions of the contracts, the transfer of ownership occurred in August 11, 2016.

The new ownership structure of Erste Bank Hungary Zrt. is the following:

Owner	Number of shares	Ownership share
Erste Group Bank AG	102,200,000,000	70%
Corvinus Nemzetközi Befektetési Zrt.	21,900,000,000	15%
European Bank for Reconstruction and Development	21,900,000,000	15%
Total	146,000,000,000	100%

As part of the agreement, both EBRD and Corvinus Zrt. delegated one member to the Supervisory Board and one non-executive member to the Board of Directors of Erste Bank Hungary.

Other changes

New regulation of the National Bank of Hungary requires minimum 15% mortgage bond funding in the net retail loan portfolio from October 2016 which has provided opportunity for Erste Hungary to establish an own mortgage bank on 2015. In the first half of 2016 the mortgage bank was granted all licenses necessary to its operation and in 2016 two bond issuance programs already occurred.

Additionally the Bank has acquired a minority shareholding of 2.3% in the Budapest Stock Exchange (BSE) from ING Bank. Róbert Cselovszki, CEO of Erste Investment was appointed as a member of the Board of Directors of BSE.

PRODUCT RANGE, COOPERATION AGREEMENTS, STRATEGIC ALLIANCES

After mainly refinancing market growth of 2015, 2016 saw a further boom in the property market and consequently in the mortgage market, as a result of housing market stimulus measures. These measures can be classified as: CSOK, low interest rate environment, as well as real estate investments. We assume that the above mentioned measures will create a preferential environment for mortgages in the future as well.

Potential mortgage customers are - as a result of past experiences - more thoughtful, more interested in carrying less risk, also in predictable, long-term fixed-rates. According to the latest statistics of the MNB, more than 50% of mortgage loans' interest period is now long (minimum 5 years) in the current market.

In order to serve the wide-range consumer needs and respond to the falling base rate, as well as adapting the demand for long interest period loans, after the introduction of five-year interest period mortgage product in March 2015, in February 2016 Erste introduced ten-year interest period loan in the market.

Besides the above mentioned, in 2016. November Erste Hungary has launched a niche product: building society bridge loan. The offer brings an alternative for the consumers: instead of waiting until the saving expires, the realization of their dream-home can be reached immediately with building society bridge loan. The instalments can be determined for 22 years in advance.

Erste Hungary's share in the retail lending market showed a rising trend throughout the year, as regards housing mortgage loans as well as home equity loans.

As of 1 July 2015, Erste Hungary was amongst the first to launch the application for the new type of state subsidies (CSOK), the introduction of which was supported by a wide marketing campaign in the home building topic (ersteotthon.hu).

In 2016 the product "market interest rate housing loan with preliminary evaluation" for the purchase of new and used apartments is still available, providing an opportunity for customers to file their loan requests already before the apartment has been chosen and the sales contract concluded, and get an offer from the Bank on the basis of their certified incomes and creditworthiness. Due to their preliminary evaluation certificates, customers are able to exactly assess the loan amount they are entitled to, and may start searching for an apartment accordingly.

After the introduction of CSOK - state subsidies – in 2015 July, the product played an important role in generating new volume in 2016.

The preferential package developed for public servants at the end of 2015 is still available at Erste Hungary. Erste Hungary still considers public sector employees as a long term important strategic segment.

In view for increasing its credit portfolio, Erste Hungary is present in the consumer lending market with a continuous DM campaigns, branch and contact center activity.

Erste Hungary serves customer needs for retail loan products with a full product range and wide scale solutions.

During 2016 Erste Hungary continued the technical and business preparation for the takeover of the retail portfolio of Citi-bank.

At the end of 2016, for our retail customers, the renewed 'Erste EgySzámlla' Account Package was introduced, which is supposed to address customers who get their salaries transferred to the Bank, and use their accounts, debit cards in an active manner. The new type of General Retail Banking Services Agreement provides better conditions to our customers, just like having the option to keep limitless number of bank accounts for one monthly customer relations fee, and to attach bankcards to any of their accounts.

Based on legal provisions the Bank introduced new account types in the 4th quarter of 2016 under the name of 'Erste Alapszámla' and 'Erste Megélhetési and Erste Adósságrendezési' accounts.

Due to the continuous MNB base rate cuts in the first half of 2016, the portfolio and the level of interest rates of sight and term deposits have been re-evaluated. In addition Erste Hungary kept continuous NetBank activation campaign of 'CélBetét' Saving Account which product provides flexible and customizable options for customers with regular savings.

The range of account products sold to micro-enterprises is still adjusted to the demands of customers. For start-up enterprises, the Erste 'Induló' Account Package, and for already operating customers with an actual account turnover the 'Válogatás Plusz' Account Package is offered. The 'Válogatás Plusz' Account Package offers a wide range of services to customers, and each customer can select the two discounts most appealing to them from the account management and transaction discounts offered in the Announcement.

Increase in micro segment was mainly driven by a newly marketed, turnover based overdraft product that was offered without collateral requirements. Offers are provided for already existing customers with positive track record as part of a semi-automated process.

Exceptional priority was given for the set up and launch of financing for the agricultural sector. As part of the strategy, Erste Hungary focused on overdraft facilities, provided for the agricultural segment further to the already existing working capital and subsidy pre-financing. All products mentioned are provided without collateral, relating product parameters have been developed solely and directly for this segment, in addition to the newly developed investment loans.

Condominium financing was also among the main focuses with a brand new loan type provided with the purpose of condominium development.

Erste Hungary continued the intensive sales of Széchenyi Card Overdraft Facilities in 2016 as well in addition to the moderate demand arised for the Funding for Growth Scheme loans.

In addition to the specifically structured loan products, Erste Hungary also offered its own financing products to its customers. To mention only the classic products: loans promoting the increase of liquidity, development and investment loans, general purpose loans, bank guarantees.

We provide all-inclusive financing service to companies and municipalities managed under the corporate business line. In the scope of this, Erste Hungary provides HUF and foreign currency loans from its own resources or in the form of refinancing further to account keeping issues credit cards and bank guarantees, opens letters of credit, and provides leasing financing and factoring services to its partners. We participate in project finance as well as in syndicated loans.

Predominant were among financing products in year 2016 the HUF loans refinanced under the MNB's Funding for Growth Scheme and the foreign currency loans refinanced by the EXIM, enabled Erste Hungary to provide financing in both HUF and foreign currencies to its partners at costs more favourable than in the case of loans disbursed from own funds. Both refinanc-

ing programmes were extended also to financial leasing funding and factoring. Further to the refinanced facilities we have launched Erste Growth Programme, in which we offer reasonable financing based on fixed rates offered from own sources.

Another characteristic element of the product structure was the loans provided against the guarantees of Garantiqa Zrt. and the Rural Credit Guarantee Foundation also in year 2016, which enable the Group to expand the range of our financed customers via risk sharing with institutional guarantors.

In the corporate lending business the customer driven approach to lending and increasing the level of system support are key aspects that contribute to the achievement of the increasingly high level of customer service. Loan processes have been continuously developed considering risk management aspects.

MAIN RESOURCES AND RISKS, AND THE RELATED CHANGES AND UNCERTAINTIES

Asset-liability management (interest rate risk management)

Erste Hungary uses a simulation procedure, one of the more advanced methodology solutions, to measure the interest rate risk of its banking book, as that method takes into account both traditionally applied approaches, i.e., the net interest-income simulation (income perspective) and the cash flow assessment, i.e., the economic value simulation (economic perspective). The highest-level strategic decisions on asset-liability management and, more specifically, interest rate risk management, are made by the Asset-Liability Committee (ALCO). In accordance with its responsibilities, the Committee regularly reviews the interest rate risk situation of Erste Hungary and the development of its positions. In addition to monitoring the position, the Committee also has the right to evaluate and rate Erste Hungary's interest rate risk position. Its competence includes the approval and modification of applicable internal regulations, with special regard to the modification of effective limits, assumptions, procedures and methods. Other organisational units involved in interest rate risk management: (1) Asset-Liability Management Directorate (ALM), which prepares decisions and supports the activities of ALCO, (2) Treasury Directorate, which performs the operational implementation of the strategic decisions of ALCO and the market transactions of ALM. Erste Hungary's management receives regular reports on the variation of the interest rate risk exposures of the banking book. Those reports enable the management:

- to evaluate the level and trend of Erste Hungary's total interest rate risk exposure;
- to check compliance with the defined risk tolerance levels;
- to identify potentially excessive risks undertaken in excess of the level set forth by the policy;
- to determine if Erste Hungary has enough capital to undertake the respective interest rate risk;
- to make decisions relating to interest rate risks.

Liquidity risk management

Erste Hungary uses a *Survival Period Analysis* based on stress scenarios to measure its shorter-term liquidity risks. The analysis shows for how long Erste Hungary would be able to fulfil its payment obligations in various liquidity stress scenarios, under specific conditions. ALM is responsible for coordinating the maturity structure of on-statement of financial position and off-statement of financial position items by ensuring that the aggregated net cash flows remain positive for the period of time specified as the limit. In addition to the survival period analysis based on stress scenarios, compliance with the liquidity ratios introduced by Hungarian regulators (FX Adequacy Ratio, Deposit and Statement of Financial Position Sheet Coverage Ratios) as well as compliance with the expected levels of the liquidity ratios (LCR, NSFR) introduced by the Basel Committee on Banking Supervision are also taken into account when managing liquidity risks. Counterparty and Market Risk Management Department regularly monitors and reports to ALCO the current figures of liquidity ratios.

During the year, the gross client loan portfolio slightly shrank but the net loan portfolio increased due to decreasing risk provision. The volume of retail loans dropped in 2016, while the corporate loan portfolio increased. The volume of client deposits grew significantly in 2016, mainly due to increasing FX deposits from financial funds. The retail deposit portfolio slightly grew during the year, caused by the increase of sight deposits. The level of deposits from non-financial corporations decreased. The flow of liquidity from term deposits to sight deposits was observable in all client segments, as well as flow from HUF to FX deposits in the case of corporate accounts.

Due to the conversion of FX retail loans and to the diminishing loan-to-deposit ratio, the external financing need of Erste Hungary decreased significantly in the last two years. Erste Hungary executed a HUF 78bn capital increase and prepaid EUR 248m subordinated deposits in the third quarter of 2016. These actions further diminished the FX financing of Erste Hungary.

Interest rate risk management

Erste Hungary applies two analytical methods to quantify interest rate risk: a) the net interest income method, and b) the simulation of the market value of total equity.

Both types of risk indicators suggested a medium interest rate risk exposure; both the external and the internal limits were met during the year. The increase in the market sensitivity of total equity is a consequence of the risk of the modelled products, which has increased due to the low yield environment.

Sensitivity of the market value of the total equity:

It is expressed as the absolute sum total of the variation of the economic capital value by currency, occurring as a result of a parallel, 200 basis point assumed change in interest rates, in any direction, compared to the capital amount calculated with an unchanged interest rate scenario.

Sensitivity of the net interest income, simulated for 12 months:

It is expressed as the absolute sum total of the variation of the 1-year net interest income by currency, occurring as a result of parallel, +100 basis point assumed change in interest rates, compared to the net interest income calculated with an unchanged interest rate scenario.

Table No. 1

	2015.12.31	2016.12.31
Sensitivity of the total equity	7.42%	6.76%
Sensitivity of the net interest income, simulated for 12 months	4.88%	7.16%

The repricing table classifies the volumes of assets, liabilities and off-balance sheet items into time bands, in the main currencies, according to the next repricing date. The repricing gap is calculated after the classification, as the difference of the assets and liabilities.

At the end of 2016, the portfolios denominated in HUF had a positive repricing gap, except for the 3-year repricing portfolio. The positive gap of the longer terms (≥ 5 years) resulted primarily from the longer-term government securities portfolio with a fixed interest rate and the corporate loan portfolio.

The interest-bearing items, denominated in USD and EUR, are dominated by deals priced within one year, i.e. those statement of financial position components carry generally low repricing risks. In the case of interest-bearing items denominated in CHF, we have surplus assets due to the CHF corporate loan portfolio. The table below does not include the demand deposit portfolio, whose maturities are modelled.

Table No.2

2016	Data in million HUF			
	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing GAP in position EUR	32,821	(28,067)	6,716	(5,605)
Repricing GAP in position HUF	(314,769)	2,142	55,093	425,541
Repricing GAP in position CHF	(863)	(3,284)	12,105	-
Repricing GAP in position USD	6,066	2,326	8,195	122

The Asset-Liability Committee (ALCO) is responsible for managing interest rate and liquidity risks at the highest decision making level.

FINANCIAL DATA

Erste Hungary's Net result for the period turned positive again in 2016 – highly beating 2015 YE result. The key factors were the considerably lower risk provisioning, mainly as a result of one-off releases and the substantially lower banking tax.

Erste Hungary's Total assets reached HUF 2.047 billion by the YE, which corresponds to a 6.4% year-on-year growth. Erste Hungary reported a HUF 43.3 billion Net result for the period.

The structure of Erste Hungary's asset portfolio shows a significant change at the end of 2016 compared to the preceding years. The portfolio of government securities, (especially government securities held as investments) grew and their share within the balance sheet total also increased.

At the same time Loans to credit institutions declined together with their share within Total assets. Placements with the National Bank of Hungary (MNB) decreased considerably (by HUF 158 billion), mainly as a result of diminishing interest rate environment and limited amount of excess liquidity, that is allowed to be placed in 3M deposits. Thus the share of receivables from credit institutions within total assets fall back slightly to 4% as compared with the 14% reported for the preceding year.

The net volume of Loans to customers increased by HUF 14,630 million – after subdued loan demand during the past years - mainly as a result of growing new disbursements.

The high level of Cash and cash equivalents decreased by HUF 5.8 billion compared to the previous year.

There were no major changes in the share of non-interest-bearing assets.

The portfolio structure within liability side is roughly the same as last year. Deposits from credit institutions although decreased by HUF 213 billion since the preceding year, thereof short-term deposits from the parent company was significant down, while long-term interbank deposits went up. Overall the share of Amounts owed to credit institutions within the balance sheet total down from 22% to 10%.

Customer deposits gained significantly by HUF 157 billion in 2016, and their share within the total balance sheet increased from 65.6% in 2015 to 69.3%. The dynamic increase is coupled with structural changes; i.e. the significant decrease of term deposits by HUF 238 billion could be compensated by the HUF 410 billion increase of demand deposits. The Bank has a 6,15% market share regarding retail deposits, which corresponds to a 14 bps drop compared to last year. While market share of sight deposits increased by 29 bps, term deposits decreased by 109 bps attributable to subdued demand for this saving form caused by diminishing interest rate environment.

There were no major changes looking at the structure of other liabilities and deferred income.

There has been a subscribed capital increase during the year, resulting in the portion of equity being 14% among total assets.

The Bank's Operating income and expenses decreased compared to the previous year, resulting in a HUF 43.3 billion Net result for the period at the end of 2016.

Regarding the elements of Operating income, Net interest decreased by 3.5% (HUF 3.6 billion) compared to previous year.

The decline of interests received was caused by the decreasing yield environment and the (FX settlement related) substantial drop in Retail customer loans. Furthermore moderate interest received after placements with the National Bank of Hungary (MNB) was offset by higher interest income earned on securities.

The HUF 13.7 billion improvement on interest expenses is caused by the diminishing interests paid on term deposits primarily due to the low level of the interest rate environment. Further to this the restructuring of savings towards sight deposits as well as the interest paid on interbank deposits also contributed to the sinking interest expenses.

The Net fee and commission income of the Bank is by HUF 1,507 million higher than as of December 2015. The growth was induced by the increase in both distribution and payment transaction fees. Alternatively in the case of card transaction fee income a slight decrease was observable in 2016.

Personnel expenses, other administrative expenses and depreciation amounted to HUF 60.9 billion in 2016, which is by 9.3% higher than the amount recognised in the same period of the previous year.

Higher Operating expenses are partly caused by the increase in Personnel related expenses in line with slightly higher wages and salaries. IT expenses also increased in relation to IT maintenance and support, while higher consultancy expenses were induced by Citi migration.

Depreciation amounted to HUF 6.3 billion and decreased by 1% compared to the previous year mainly due to depreciation mainly on softwares.

At the end of 2016, the Bank's capital adequacy was stable; the ratio after the deductions of Pillar III is 17.7% was higher than the statutorily required level (8% in 2016).

Regulatory own funds amounted HUF 272,968 million (2015 Pillar II data: HUF 280,823).

OPERATIONS OF SUBSIDIARIES

Erste Hungary has a determinative role in Hungarian financial market. Erste Hungary's operation is over the banking activity as it contains investment services, leasing and factoring services and asset and property management services. To increase the efficiency Erste Hungary rationalized the group structure by merging the activities to less legal entities. The following tables that include the financial data of subsidiaries are based on individual financial statement of the subsidiaries in accordance with Hungarian accounting rules as audited figures are not available just on consolidated basis.

Erste Befektetési Zrt.

The Company provides investment services.

The Company was founded in 1998. Due to its hard continuous work nowadays the number one brokerage company on the Hungarian capital market. The volume of the products available for customers increased continuously. The Company's goal to provide high level services to customers on a quicker and simpler way. In the branches of Erste Bank Hungary on-line trading system ensure that the customer's orders met regarding stock-exchange and government bonds in anywhere in the country.

Main financial data

in THUF	2015	2016	Change %
Total assets	82,365,997	156,410,493	89.89
Total equity	10,250,570	10,907,160	6.41
Issued capital	2,000,000	2,000,000	-
Profit or loss for the year	1,981,133	2,456,590	23.99

Leasing services:

Within the Group one company provides financial leasing services and one company provides operative leasing services. On 1 January 2013 5 financial companies merged in to the Bank (Erste Leasing Autófinanszírozó Zrt., Erste Leasing Eszközfinanszírozó Zrt., Erste Ingatlanlizing Zrt., Erste Faktor Zrt., and Magyar Factor Zrt.). The business goal was to achieve a high safety customer portfolio.

Erste Lakáslizing Zrt.

Erste Lakáslizing Zrt's main activity is property in use leasing.

Main financial data

in THUF	2015	2016	Change %
Total assets	2,674,313	2,330,414	(12.86)
Total equity	231,987	223,264	(3.76)
Issued capital	53,000	53,000	-
Profit or loss for the year	74,614	(24,720)	(133.13)

Erste Ingatlan Kft.

The Company's main activities are the followings: property sale, property leasing and property management activities.

Main financial data

in THUF	2015	2016	Change %
Total assets	41,452,980	42,344,611	2.15
Total equity	39,671,251	40,746,213	2.71
Issued capital	210,000	210,000	-
Profit or loss for the year	(166,704)	1,074,962	744.83

Sió Ingatlan Invest Kft.

Sió Ingatlan Invest Kft. is a project company that developed the SIÓ Shopping Center at Siófok city. The Company is owned by Erste Ingatlan Kft. in 100%.

Main financial data

in THUF	2015	2016	Change %
Total assets	3,525,880	3,340,432	(5.26)
Total equity	3,283,025	3,085,841	(6.01)
Issued capital	12,900	12,900	-
Profit or loss for the year	(422,795)	(197,184)	53.36

Erste Lakástakarék Zrt.

Erste Lakástakarék Zrt. is a credit institution that deals with building society. Its license has been issued on 29 September 2011 by the Financial Supervisory Authority and started its trading activity on 17 October 2011.

Main financial data

in THUF	2015	2016	Change %
Total assets	39,420,669	57,205,948	45.17
Total equity	3,450,396	5,722,919	65.86
Issued capital	2,015,000	2,025,000	0.50
Profit or loss for the year	(828,382)	(1,727,477)	(108.54)

Collat-real Kft.

The Company was founded on 10 March 2014 by Erste Bank Hungary Zrt. The Company's main activity is property management.

Main financial data

in THUF	2015	2016	Change %
Total assets	6,403,896	6,366,996	(0.58)
Total equity	6,390,562	6,348,627	(0.66)
Issued capital	3,000	3,000	-
Profit or loss for the year	(32,196)	(41,935)	30.25

Erste IN-FORG Kft.

The Company was founded on 28 March 2013 by Erste Ingatlan Fejlesztő, Hasznosító és Mérnöki Kft. The Company's main activity is trading with properties repossessed by Erste Bank Hungary and its partners.

Main financial data

in THUF	2015	2016	Change %
Total assets	432,393	491,082	13.57
Total equity	416,217	482,799	16.00
Issued capital	5,000	5,000	-
Profit or loss for the year	14,957	66,582	345.16

Erste Jelzálogbank Zrt.

The Company was founded on 11 December 2015 by Erste Bank Hungary Zrt. The Company's main activity is refinancing.

Main financial data:

in THUF	2015	2016	Change %
Total assets	3,885,508	57,896,299	1390.06
Total equity	3,875,096	3,898,782	0.61
Issued capital	3,000,000	3,000,000	-
Profit or loss for the year	(24,904)	21,317	185.60

QUANTITATIVE AND QUALITATIVE PERFORMANCE INDICATORS AND MARKERS FOR THE PROCESSES

Erste Hungary measures the quality of its internal operations through the main customer service channels (branch, Contact Center, electronic channels), and through the performance of its major customer service processes. The performance requirements for customer processes and service channels are defined following an assessment of customer needs. We conduct regular researches: annual customer satisfaction and customer expectations surveys, mystery shopping in branches, and research of the willingness of branch advisers to make referrals.

Customer needs and expectations are converted into indicators and measurable parameters. As a primary focus, we build a system of indicators for business processes and channels in Erste Hungary, and conduct measurements to determine the performance of the processes. Our processes are analyzed from the occurrence of the customer needs to the satisfaction of those needs. Main indicators describing process capacities: processing time, number of errors, service levels, for example the measuring of waiting times, or NetBank availability. Target values are defined for these indicators, and the results of the regular measurements are compared to the desired target values.

If the performance of a process remains below the target, a detailed process analysis is conducted to identify the reasons of non-compliance, and development proposals are elaborated. This activity is performed weekly and monthly, involving the areas affected by the process. If necessary, we launch a project for improving the process, where we work out action plans using process improvement methodologies (LEAN, Six Sigma) in order to increase the efficiency of the process.

In 2016 the main focus was on the Citi retail portfolio migration project, through which new customer service processes and information platforms have been established (www.ujbankom.hu) to ensure a clear and understandable migration for our clients. During the project, 150 customer processes have been reviewed and modified by the involvement of every customer channel (branch network, personal advisers, call center, complaint handling, correspondence, collection). Customer experience of the processes has been analyzed in detail and negative impacts were mitigated. Customer satisfaction will be measured in Q1 2017 after the portfolio migration.

EMPLOYMENT POLICY

Erste Hungary's year-end headcount did not significantly change during 2016. at the end of 2016, the Bank had 2,873 employees (projected to 8-hour employment), disregarding trainees. Erste Hungary's average 2016 headcount was a bit lower compared to 2015, no significant change throughout the year. In line with the long-term strategy of Erste Hungary, the projects supporting its development and improvement continued and the preparation for the takeover of the Consumer Business of Citibank continued in 2016.

The average age of our employees is 37 years, and the average length of their employment is 6.9 years.

During 2016 Erste Hungary provided an opportunity for 161 trainees within the framework of a trainee programme to get an inside view of Erste Hungary's operation and to acquire work experience. 9% of those participating in Erste Hungary's trainee programme were hired as employees of Erste Hungary.

DESCRIPTION OF BUSINESS PREMISES

Erste Hungary's registered office has been at Népfürdő utca 24-26 since 1 September 2006. The modern office building hosts the organisational units of Erste Hungary's head office and the subsidiaries. Erste Hungary has a nationwide branch network, which is professionally controlled at regional level (Budapest 1., Budapest 2., North-East Hungary, South-East Hungary, East Hungary, West Hungary, Middle-West Hungary). The branches are listed in Annex No. 1.

EDUCATION POLICY

Similar to the previous years Erste Hungary has been concluded a wide range of development activities in 2016. It means that in general all of our employees spend 3.73 working days with trainings. The main development focuses were the deepening of the professional knowledge, the internal process development and the increase of the effectiveness of our sales and customer care activities. In 2016 we also emphasized the English language courses among our colleagues mainly in our Risk Division.

In the Retail division we continued the intensive preparation of our new joiners, we introduced a new 3 level micro enterprise training system and our internal trainers lay down the base of a new mortgage loan training which is aligned with all the relevant EU directives. Our digital channel and private banking directorates focused to the sales techniques and customer care development in 2016 and those directorates who are responsible for the products and processes participated in professional conferences and workshops.

The corporate division divided the development focuses among sales techniques and agricultural professional courses furthermore they have been initiating a new leadership/organizational development process.

Our IT division pays attention to its managers' leadership and professional development and all staff level we closed our talent management program and since October the Erste/Citi integration related trainings got the biggest emphasize.

CORPORATE SOCIAL RESPONSIBILITY

Erste was established 200 years ago with the concept of letting everyone have a share from prosperity, irrespective of social status, nationality, religion, sexual orientation, or age. Protecting and expanding that prosperity is among our ongoing objectives. One of the key statements in our future vision says "Our commitment to our customers and Hungary is evidenced by our social responsibility acts besides our banking and investment services".

Therefore, in our complex world Erste Hungary seeks to be more than simply a business enterprise that provides financial solutions. In fact, the bank offers solutions to life situations. In this context, the bank not only confirms its commitment to Hungary and Hungarian citizens through its banking and investment activities but also through social responsibility functions implemented as a responsible employer.

Erste Hungary's activities in Corporate Social Responsibility rests on two pillars: the Hungarian activities of Erste Stiftung [Erste Foundation], the Good.bee program, and the bank's own CSR program dubbed "+1 tett" [+1 Act] as part of which our volunteer program dubbed Közösségi csapatmunka [Community Team Work] was launched in 2015, actively involving our employees.

ERSTE Foundation in Hungary

Established in 2003 from Erste Österreichische Spar-Casse, the first savings cooperative in Austria founded in 1819, ERSTE Foundation (ERSTE Stiftung) is the biggest foundation in the savings cooperatives sector in Austria.

As the majority shareholder in Erste Group, ERSTE Stiftung is dedicated to foster social development in Central and South-east Europe, realising this commitment through projects initiated or sponsored in the scope of three programs: Social Development, Culture, and Europe.



ERSTE Stiftung

Further information: <http://www.erstestiftung.org/>

+1 tett program



“Our commitment to our customers and Hungary is evidenced by our social responsibility acts besides our banking and investment services”. It was in the spirit of this motto, taken from Erste’s future vision, that our program “1+tett” [“1+Act”] was launched in 2014 with an application designed to identify communities and projects that provide efficient help in resolving matters of social focus, as well as in the topics of self-care and digitalisation. At the same time, in addition to providing financial support, employees of Erste Hungary actively participated in the projects, supporting the work of the selected organisations with their expertise.

As part of the program Erste Hungary entered into cooperation with three organisations:

Salva Vita Alapítvány – Plus one idea that only you can give



We at Erste Hungary believe that every person should be granted access to financial services. Finances, however, are often too hard to understand even for average people. Salva Vita Alapítvány [Salva Vita Foundation] has been engaged for years in fostering social integration of persons with disabilities or impaired work ability for whom management of finances or the related administrative tasks and use of banking services present difficulties. Particularly for our fellow human beings with mental

impairments who have a hard time finding their way around in the world of often too complex rules, processes, and online interfaces. In its application Salva Vita Alapítvány offered a solution to this problem by creating a “financial guide”, which is comprehensible by all and may even be used as a teaching material. Enthusiastic experts from Erste Hungary helped the Foundation compile the publications. The guide, dubbed Pénzügyi 1X1 [Finances 101], has been disbursed in thousands of copies in specialised schools across the country. In addition to the publication, “ERSTE-Salva financial orientation classes” were held at 10 special schools by the Foundation with involvement from volunteering employees of the bank.

Erste Hungary’s Pénzügyi1X1 Program was granted Most Innovative Sponsorship Program in 2015 by Magyar Adományozói Fórum [Hungarian Donors Forum]

Homepage of the organisation: <http://salvavita.hu/>

Együttható Egyesület - +1 reason for online security

Együttható Egyesület [Co-efficient Community Development] was founded in 2011 with the aim of organising nonexistent and gap-filler programs for youth. One of those programs is Surf Safe, focusing on safe Internet use and conscious media consumption. As part of the program, group classes are organised at weekends and preventive school classes are held for youth between 10 and 18 years of age. Enthusiastic experts from Erste Hungary joined this initiative, attending a number of classes in the course of the cooperation and sharing their views with youth interested in the topic. The volunteering work was preceded by a through prep training and content generating workshop. The banking experts’ approach on financial security and their first-hand experience were especially valuable.

Homepage of the organisation: <http://www.egyutthato.eu/>

Szimbiózis Alapítvány - +1 busy hand

Sponsored by Erste Hungary, alpaca therapy has been introduced by Szimbiózis Alapítvány [Symbiosis Foundation] as a unique concept in the country so far. Using the funds awarded in the application, the Foundation purchased a couple of alpacas and an open-air coral/stable, feeder, fence, gate, and information post were made with help from volunteering employees of Erste Hungary. Later on, experience gained in alpaca rearing and therapy will be disseminated in Hungary and internationally, and then alpaca wool processing will start subsequently (the wool will be used in producing felt in the artisan workshop). The “+1 Act” program has contributed to the financial and business sustainability of alpaca rearing as a therapy opportunity in Hungary.

Homepage of the organisation: <http://szimbiozis.net/>

+1 Act – Community teamwork

Taking the +1 Act program one step further, Erste Hungary — relying on its employees — launched a new volunteering program in 2015, dubbed Közösségi csapatmunka [Community Teamwork]. As part of the program employees of Erste Hungary are given a chance to apply for volunteering in implementing programs they have selected themselves. As an important aspect, our colleagues themselves had to organise the program within community teamwork that they have applied for, while Erste Hungary provides the time and funding necessary for the program.

Within the framework of the program, diverse cooperation projects were implemented such as repainting the signals of trekking trails, supporting the financial education of children in state custody or living with foster parents, or organising dragon boat events for underprivileged children. In 2015, nearly 300 Erste employees participated in community teamwork projects and their number grew to more than 350 in 2016.

In October 2016, the program was granted the special award for volunteering by Magyar Adományozói Fórum [Hungarian Donors Forum].

News of volunteering programs initiated as part of our Community Teamwork have been posted continually on the Bank’s Facebook page.

Additional cooperation projects

Virtuózok

“Winning a contest is merely the first step towards success. Afterwards, you have to manage your talent as skilfully as you manage your financial resources”. Erste Hungary was not only the main sponsor of the televised talent show Virtuózok [Virtuosos] but also participated as financial mentor to the young talents.

Cellist Tamás Kökény won the main prize of the programme. HUF 12 million provided by Erste Hungary, which was accompanied by a concert opportunity in New York’s Carnegie Hall. The other two age group winners were granted HUF 500.000 each, also provided by Erste Hungary.



Kékszalag Erste World Nagydíj

In 2016, Erste Hungary’s new service Erste World debuted as naming sponsor to the 48th Kékszalag Nagydíj [Blue Ribbon Grand Prix]. Erste World’s universe is similar to the world of sailing: the Blue Ribbon Grand Prix attracts those who appreciate real performance and real values. This is exactly what Erste World promises in the scope of financial services: we help customers find real values, create real wealth from their assets, because property turns into value when you use it to lay down the foundations of your family’s future and happiness and yours as well.

At the location of the sailing race, Erste World offered special programs, including a lounge that featured the values of the Lake Balaton region and a VIP section designed for priority guests. Involving local partners, Erste World Club debuted at the venue, offering value-creating partnership to VIP customers and partners alike.

Mosoly Alapítvány

Since 2014 Erste Hungary has sponsored the initiative Mosoly Váltó [Smile Relay], launched by Mosoly Alapítvány [Smile Foundation], in which some of our enthusiastic employees were running in a 4-kilometre stretch alongside kids who had recovered from serious illnesses.

Further information: <http://mosolyalapitvany.hu/hu/>

Szimplakert Közös Lábos Program

Erste Hungary joined Közös Lábos Program [Common Pot Program] in 2014, an initiative organised by Szimplakert [Simple Garden] which has become something of a tradition by now. With help from volunteering Erste Hungary employees, donations are collected every time in the course of the program: the meals prepared by our staff are sold on the basis of honour system and the amounts thus realised are offered to select organisations. Most recently, in March 2015, the donations offered in the open-air cooking in Szimplakert were transferred to 90 Decibel Alapítvány [90 Decibels Foundation]. The Foundation spends the amounts realised on providing ease of access — primarily in theatres and museums — for those living with hearing or visual impairment.

Further information: <http://szimpla.hu/hirek/kozoslabos>

United Way book donation to develop reading skills of underprivileged children

In the spring of 2015, a book donation campaign dubbed KÖNYVFORGATÓ (Book Turner) was organised at Erste Hungary’s headquarters in cooperation with United Way with the aim to draw the attention to the importance of reading, at the same time helping underprivileged children’s comprehensive reading. Within the book donation program hundreds of books were collected in May 2015 and November 2016. In 2015, Erste Hungary emerged the company with the highest number of books ever donated.

Further information: <http://www.unitedway.hu/>

Donut sale for Nemzetközi Cseperedő Alapítvány

Charity donut sales have been organised in cooperation with Nemzetközi Cseperedő Alapítvány [International Growing-up Foundation] at Erste Hungary's Headquarters since 2014 twice a year with involvement from donut shop Fánki Donut. In the sponsorship project Erste Hungary purchases the donuts being sold by the Foundation's staff at Erste Hungary's Headquarters on a specific day. When the donut sale project was launched, 300 donuts were made, but in February 2016 over a thousand donuts were sold in just 90 minutes! The entire proceeds from the donut sale went to the Foundation, supporting kids living with communication and social skill disorders, in particular autism, and their environment. In recent years, a total of nearly HUF 2 million has been donated this way.

Let's crowdfund it – Collaboration with NIOK

One of Erste Hungary's events organised for its employees featured a special charity program in 2016: donations were collected in collaboration with Nonprofit Információs és Oktató Központ [Non-profit Information and Training Centre; NIOK]. A special feature of the donation collection was the interface: it was managed through a website (<http://www.adjukossze.hu/>) based on crowdfunding model and operated by NIOK. The beneficiaries of the donation collection were foundations and organisations that were familiar to Erste Hungary employees from previous campaigns, including Nemzetközi Cseperedő Alapítvány [International Growing-up Foundation] (sponsoring youth living with autism); Dévai Szent Ferenc Alapítvány [Saint Francis of Déva Foundation] (representing the interests of underprivileged children, fostering their mental and social development; ensuring social protection; promoting and supporting their upbringing); and Tappancs Állatvédő Alapítvány [Paws Animal Protection Foundation] (protection of animals and operating an animal shelter). The targets were defined jointly: each foundation requested a donation of HUF 300.000. The collection was a success.

The donated sums were spent on:

- Dévai Szent Ferenc Alapítvány can now renovate one of the wings of Castle Stubenberg in Székelyhíd, creating a home for another 20 kids that live in extreme poverty.
- Tappancs in Szeged can now install 10 chew-resistant, insulated doghouses at the animal shelter, protecting cats and dogs from the elements.
- Cseperedő Alapítvány can now enlarge further the first library in the country that focuses on autism and provides fresh knowledge and insight into autism at a single location to all stakeholders.

Further information: <http://www.adjukossze.hu/>

Erste Green

Erste Hungary is committed to environment protection, taking responsibility for the environment and society in which we live and work. In addition to complying with the requirements defined by its parent company (such as reduction in CO2 emission, paper usage, electric energy consumption), Erste Hungary takes additional steps to make our organisational culture and operation greener and more environment-conscious, hence expanding our commitment to corporate social responsibility.



Erste Green, a voluntary initiative of our employees for the purpose of implementing environment protection objectives, was launched early 2016. The primary aim is to draw attention to the topic in the Bank along with education and enhancing our colleagues' engagement in our environment.

The campaigns organised by Erste Green to date have been aimed at raising colleagues' awareness and educate them on the topic. The campaign included wearing green clothes on Earth Day, a dedicated Erste Green tent on Erste Day where colleagues could participate in environment quizzes and measuring ecological footprint. A photo contest with environment protection as its topic was also organised. On the other hand, Erste Green has embraced measures that even outsiders could relate to, including volunteering to collect trash at the Danube bank next to Erste Hungary's headquarter, clearing a trekking trail in the Pilis Mountains and repainting the signage, implementing the ISO 50001 standard that endeavours to reduce energy costs and emission of gases that cause greenhouse effect.

Customers with disability

Erste Hungary continues to dismantle accessibility obstacles at retail branches in order to facilitate for customers living with disabilities and confined to wheelchairs to manage their banking matters as conveniently as possible. As a result of the pro-

gram. the bank has modified 81 out of its 124-unit branch network in Hungary to date to make them disabled-friendly by ensuring full access to the entrances and creating larger spaces inside the branches for easier manoeuvring in the customer area. Going forward, all bank branch investments will be implemented with ease of access in mind unless physical or other obstacles arise.

ERSTE HUNGARY'S ENERGY EFFICIENCY

Erste Hungary attaches great emphasis on improving and sustaining energy efficiency both in its central buildings and branch network.

The central locations of Erste Hungary are Class A office buildings constructed with up-to-date architecture standards, modern heating and cooling technologies, and facility monitoring systems. Motion sensors as well as energy efficient and LED lighting sources have been installed at numerous locations in the buildings. The heating and air conditioning systems are operated in energy-saving mode at night and during the weekends. All workstations in the buildings have natural illumination, an important aspect for employees' health and for our commitment to reduce energy consumption as well.

By constant development, the appliances providing the energy supply of the building are replaced with more efficient appliances that meet the demands with a higher level of efficiency.



Focusing on environment consciousness, selective waste disposal units for paper and plastic refuse as well as communal waste have been placed in the central buildings. Plans include introducing selective waste disposal in the branch network as well.

A total of 8.000 MWh of green power has been purchased for 2016 and 2017, which not only reduces Erste Hungary's CO2 emission directly, but also fosters the expansion of innovative and renewable energy generation indirectly.

In order to ensure continuous maintenance and development of energy management efficacy, a power management system equivalent to the ISO50001 standards has been implemented by the end of 2016.

The energy-efficient design of the branch network is ensured by continuously evolving planning standards. A lower level of energy consumption for the periods outside business hours is facilitated with changes in the operating mode aligned with opening hours.

Artificial illumination is provided using energy-efficient neon lighting and LED light fittings set in line with demands. Logo illumination is controlled by timers; most of the night illumination is limited. All new appliances installed carry energy certificate 'A'.

When selecting air conditioning systems for new installation, VRV (thermal pump) and inverted appliances which ensure efficient use of energy are preferred. Recently installed furnaces are of the condensing type.

In order to reduce paper consumption, Erste Hungary has implemented the option of cash withdrawal from home ATMs without receipt. Additionally, recyclable, environment-friendly paper is used in the Bank's ATMs and also in its daily workflow.

In Erste Hungary's internal mailing system, envelopes that can be re-addressed 24 times are used as well as recyclable paper and stamps.

Obsolete but still operable computers as well as unused furniture are donated to education institutions in need, and also to foundations. Used paint cartridges from copy machines and printers are collected by the suppliers.

In order to reduce the direct harmful effects of traffic on the environment, priority is given to checking the emission levels of company cars when they are undergoing regular maintenance. For biking colleagues a space in Erste Hungary's central buildings is provided to park approximately 180 bicycles simultaneously as part of our commitment to promote a healthy and environment-friendly way of commute.

EVENTS AFTER THE BALANCE SHEET DATE

Purchase of Citibank's Hungarian retail banking and cards business

In February 2017 Erste Hungary completed one of the largest bank portfolio acquisitions in the last 10 years by acquiring the Hungarian consumer banking business of Citibank Europe plc. The transaction resulted in Erste Hungary having the second largest retail customer portfolio in Hungary. As part of the acquisition process, making headway in asset management, Erste Hungary launched the new Erste World segment in March 2016, expanding its mass-affluent and private banking services. Conforming to the scale and complexity of the deal, the acquisition contract provides a 90 day post-migration period for the parties in order to calculate and finalise the purchase price. The end of this period falls after the issuance data of the financial statement of the business year 2016.

The transaction includes the take over of the following financial instruments, migrated into Erste Hungary as of 4 February 2017, subject of further reconciliation till May 2017 as prescribed by the contract:

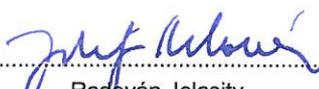
	number of accounts	amount in billion HUF
credit cards (pieces w/o sub card)	106.000	33.8
loans	18.800	16.8
deposits	88.600	160
securities under management	7.000	135.5

Based on the preliminary purchase price data and the migrated amounts before the post-migration finalization the Bank recognized intangible assets as well, such as goodwill (0.76 billion HUF) and customer relationship (6.9 billion HUF).

Curia decision

By the decision of the Hungarian Competition Authority of 19 November 2013 11 leading Hungarian banks were fined for harmonised activities in setting their practices in the case of the "Endpayment" scheme (details of the scheme see in point C) in the period of 15 September 2011 - 30 January 2012. The decision was appealed and the legal case continued at Supreme Court (Curia). By the Curia decision due to the imperfection of the legal procedure the original decision is niled and new procedure is ordered. Conforming to the decision the Bank allocated legal provision in 2017, in the amount of the original fine of 1.7 billion HUF.

Budapest, 7 April 2017


.....
Radován Jelasity
Chairman and Chief Executive Officer


.....
Ivan Vondra
Chief Financial Officer

1. Annex No. 1 Branch network of the Bank as of 31 December 2016:

No.	Branch	City/town
1	Ajkai Branch	Ajka
2	Aréna Pláza Branch	Budapest
3	Árkád Üzletközponti Branch	Budapest
4	Bajai Branch	Baja
5	Balassagyarmati Branch	Balassagyarmat
6	Baross téri Branch	Budapest
7	Bartók-Házi Branch	Budapest
8	Béke téri Branch	Budapest
9	Békéscsaba. Andrássy úti Branch	Békéscsaba
10	Budaörsi Branch	Budaörs
11	Campona Branch	Budapest
12	Ceglédi Branch	Cegléd
13	Corvin negyed Branch	Budapest
14	Csepeli Branch	Budapest
15	Csornai Branch	Csorna
16	Danubius ház Branch	Budapest
17	Deák téri Branch	Budapest
18	Debrecen. Belvárosi Branch	Debrecen
19	Debrecen. Egyetemi Branch	Debrecen
20	Debrecen. Piac u. Branch	Debrecen
21	Debrecen. Vár u. Branch	Debrecen
22	Dombóvári Branch	Dombóvár
23	Dunaharaszti Branch	Dunaharaszti
24	Dunakeszi Branch	Dunakeszi
25	Dunaújvárosi Branch	Dunaújváros
26	Egri Branch	Eger
27	Egry József utcai Branch	Budapest
28	Érdi Branch	Érd
29	Erste World Branch Debrecen	Debrecen
30	Erste World Branch Győr	Győr
31	Erste World Branch Kecskemét	Kecskemét
32	Erste World Branch Kossuth tér	Budapest
33	Erste World Branch Mammut II.	Budapest
34	Erste World Branch Miskolc	Miskolc
35	Erste World Branch MOM Park	Budapest
36	Erste World Branch Pécs	Pécs
37	Erste World Branch Szeged	Szeged
38	Erste World Branch Székesfehérvár	Székesfehérvár
39	Erste World Branch Vörösmarty tér	Budapest
40	Erste World Branch Zalaegerszeg	Zalaegerszeg

41	Erzsébet krt.8. Branch	Budapest
42	Esztergomi Branch	Esztergom
43	Eurocenter Branch	Budapest
44	Európa Torony Branch	Budapest
45	Fehérvári út 130. Branch	Budapest
46	Flórián téri Branch	Budapest
47	Gödöllői Branch	Gödöllő
48	Gyöngyösi Branch	Gyöngyös
49	Győr. Árpád úti Branch	Győr
50	Győr. Bajcsy-Zs. úti Branch	Győr
51	Gyulai Branch	Gyula
52	Hajdúböszörményi Branch	Hajdúböszörmény
53	Hajdúnánási Branch	Hajdúnánás
54	Hajdúszoboszlói Branch	Hajdúszoboszló
55	Hatvani Branch	Hatvan
56	Heltai Jenő téri Branch	Budapest
57	Hódmezővásárhelyi Branch	Hódmezővásárhely
58	Hűvösvölgyi Branch	Budapest
59	Jászberényi Branch	Jászberény
60	Kalocsa Branch	Kalocsa
61	Kálvin téri Branch	Budapest
62	Kaposvári Branch	Kaposvár
63	Karcagi Branch	Karcag
64	Kazincbarcikai Branch	Kazincbarcika
65	Kecskemét. Dobó körúti Branch	Kecskemét
66	Kecskemét. Kossuth téri Branch	Kecskemét
67	Keszthelyi Branch	Keszthely
68	Királyhágó téri Branch	Budapest
69	Kiskunfélegyházi Branch	Kiskunfélegyháza
70	Kiskunhalasi Branch	Kiskunhalas
71	Kispesti Branch	Budapest
72	Kisvárdai Branch	Kisvárd
73	Komáromi Branch	Komárom
74	Kossuth téri Branch	Budapest
75	Kőbányai Branch	Budapest
76	Köki Terminál Branch	Budapest
77	Krisztina téri Branch	Budapest
78	Makói Branch	Makó
79	Mammut II. Branch	Budapest
80	Mammut II.. emeleti Branch	Budapest
81	Mátészalkai Branch	Mátészalka
82	Mezőkövesdi Branch	Mezőkövesd

83	Miskolc. Bajcsy-Zs. u. Branch	Miskolc
84	Miskolc. Corvin u. Branch	Miskolc
85	Miskolc. Városház téri Branch	Miskolc
86	Mohácsi Branch	Mohács
87	MOM Park Branch	Budapest
88	Móri Branch	Mór
89	Mosonmagyaróvári Branch	Mosonmagyaróvár
90	Nagykanizsa. Belvárosi Branch	Nagykanizsa
91	Nyírbátori Branch	Nyírbátor
92	Nyíregyháza. Korzó Branch	Nyíregyháza
93	Nyíregyháza. Országzászló téri Branch	Nyíregyháza
94	Nyugati téri Branch	Budapest
95	Orosházi Branch	Orosháza
96	Paksi Branch	Paks
97	Pápai Branch	Pápa
98	Pécs. Diana téri Branch	Pécs
99	Pécs. Rákóczi úti Branch	Pécs
100	Pesterzsébeti Branch	Budapest
101	Pólus Irodaház Branch	Budapest
102	Private Banking Debrecen. Vár utcai Branch	Debrecen
103	Private Banking Győr. Bajcsy-Zs úti Branch	Győr
104	Private Banking Kecskemét. Kisfaludy utcai Branch	Kecskemét
105	Private Banking Miskolc. Bajcsy-Zsilinszky utcai Branch	Miskolc
106	Private Banking MOM SAS torony	Budapest
107	Private Banking Pécs. Rákóczi téri Branch	Pécs
108	Private Banking Szeged. Széchenyi téri Branch	Szeged
109	Private Banking Székesfehérvár. Palotai úti Branch	Székesfehérvár
110	Private Banking Zalaegerszeg. Ispotály közti Branch	Zalaegerszeg
111	Rákóczi téri Branch	Budapest
112	Rákoskeresztúri Branch	Budapest
113	Salgótarjáni Branch	Salgótarján
114	Sárospataki Branch	Sárospatak
115	Sárvári Branch	Sárvár
116	Siófoki Branch	Siófok
117	Sopron. Előkapu Branch	Sopron
118	Szabadság téri Branch	Budapest
119	Szarvasi Branch	Szarvas
120	Százhalombattai Branch	Százhalombatta
121	Szeged. Kölcsey u. Branch	Szeged
122	Szeged. Széchenyi téri Branch	Szeged

123	Székesfehérvár. Budai úti Branch	Székesfehérvár
124	Székesfehérvár. Palotai úti Branch	Székesfehérvár
125	Szekszárdi Branch	Szekszárd
126	Szentendrei Branch	Szentendre
127	Szentesi Branch	Szentes
128	Szentgotthárdi Branch	Szentgotthárd
129	Szigetszentmiklós Auchan Branch	Szigetszentmiklós
130	Szolnok. Baross u. Branch	Szolnok
131	Szombathely. Mártírok tér Branch	Szombathely
132	Tatabányai Branch	Tatabánya
133	Tatai Branch	Tata
134	Teréz körúti Branch	Budapest
135	Thököly úti Branch	Budapest
136	Tiszaújvárosi Branch	Tiszaújváros
137	Törökszentmiklósi Branch	Törökszentmiklós
138	Újpesti Branch	Budapest
139	Váci Branch	Vác
140	Váci út 33. Branch	Budapest
141	Várpalotai Branch	Várpalota
142	Veszprém. Ádám Iván utcai Branch	Veszprém
143	Vörösmarty téri Branch	Budapest
144	Westend Branch	Budapest
145	Záhonyi Branch	Záhony
146	Zalaegerszeg.Ispotályközi Branch	Zalaegerszeg
147	Zirci Branch	Zirc

2. Annex No. 2: Erste Bank Hungary Zrt. Corporate Governance Report for year 2016

ERSTE BANK HUNGARY Zrt. CORPORATE GOVERNANCE REPORT FOR THE YEAR 2016

Under Section 95/B of Act C of 2000 on Accounting, ERSTE BANK HUNGARY Private Limited Company („the Company”) hereby publishes its Corporate Governance Report.

The Company established its corporate governance system in a responsible, efficient and transparent manner, in accordance with the effective legislation applicable to companies and credit institutions, the recommendations from and expectations of the MNB (financial supervisor), keeping the interests of clients and Shareholders in mind.

The Company, as an issuer of certain listed securities prepared its corporate governance report – to ensure transparency and full comparability – in accordance with Corporate Governance Recommendations (“Recommendations” or “CGR”) approved by the Board of Directors of the Budapest Stock Exchange Zrt. on 12 November 2012. The Company stresses however that the company is a credit institution operating as a private limited company, which applies the recommendations prepared for listed public limited companies with the derogations arising from its organization, activities and operations, as follows.

PART I

1. Operation of the Board of Directors, and a description of the division of responsibility and duties between the Board of Directors and the executive management

The Board of Directors as executive body of the Company governs the operation of the Company and its management in the framework set by legislation, the Company Statutes (“the Statutes”) and the resolutions of the Company’s General Meeting (“the General Meeting”), and by taking into account the recommendations from its Supervisory Board. It sets its own by-laws after seeking the opinion of the Supervisory Board.

The Board of Directors’ competence is, under the Statutes and the by-laws of the Board of Directors, amongst others, the preparation of the reports under the Accounting Act¹ (including the proposal for a decision to deploy the profit after tax), the preparation of the budget, the approval of the Company’s organizational structure, the approval of certain by-laws specified in the Credit Institution Act²; decision-making on the establishment and the dissolution of subsidiaries.

The Board of Directors consists of at least 3 members, elected by the General Meeting for a maximum of 5 years. The Board of Directors’ members can be reappointed and dismissed by the General Meeting.

The members of the Board of Directors are employed by the Company (internal members), and persons not employed by the Company (external members).

1. Act C of 2000 on Accounting

2. Act CXII of 2013 on Credit Institutions and Financial Enterprises

The Chairman of the Board of Directors organizes the Board of Directors' work, ensures the efficient operation of the Board of Directors, represents the Board of Directors and carries out the tasks specified in the Statutes and the Board of Directors' by-laws in connection with the holding of the meetings and other tasks.

The meetings of the Board of Directors are held with the necessary frequency, but at least 4 (four) times a year. The Chairman of the Board of Directors is required to convene a Board of Directors meeting upon a written request from any member, specifying the reason for convening the meeting and the proposed agenda. The invitation must be sent in advance to the Board of Directors members as set out in the by-laws.

The Board of Directors has a quorum if more than half of its members are present. The Board of Directors makes its decisions with a simple majority of the members present, by taking into account Sections 13.9 and 13.10 of the Statutes unless it is otherwise provided by the relevant legislation or the Statutes.

The Board of Directors may pass its resolutions in writing (including via fax), teleconference or videoconference.

The internal members of the Board of Directors are the CEO, the Retail Deputy CEO, the CFO, the Deputy IT and Operations CEO and the Deputy Risk Management CEO, who govern the organizational units belonging to them in order to perform their duties.

The Chairman elected by the Board of Directors and employed by the Company (in 2016 and currently the CEO), and his deputies (in 2016 and currently the internal Board of Directors members) qualify as executive managers under the Credit Institution Act. The Board of Directors decides on the distribution of business activities amongst the executive directors and the rules for replacement. The Board of Directors' decisions are implemented by the executive directors.

The Board of Directors established, within its college, a Managing Board. The Managing Board is a body engaged in the everyday operational management of the Company, drafting the decisions and principles required for the everyday operation, the competence of which covers, amongst others: management and supervision of pending Company matters, making decisions required for the everyday business operation, issuing by-laws, decision on bringing court cases, provided that these decisions are not within the exclusive competence of the Board of Directors or other bodies under the internal by-laws or effective legislative provisions.

The members of the Managing Board are the Chairman of the Board of Directors, the CEO and the Deputy CEO's, who are also members of the Board of Directors. The CEO is the Chairman of the Managing Board.

The Managing Board convenes a Managing Board meeting at a weekly frequency. The Managing Board meeting has a quorum if more than half of its members are present. The Managing Board meeting adopts its decisions with a simple majority.

The Managing Board informs the Board of Directors of the measures and decisions made on a quarterly basis.

In year 2016 the Board of Directors' decisions related, amongst others, the following matters:

- reports of the management
- Risk Management Reports
- adoption of the amendments of internal regulations within the competence of the Board of Directors.
- preparation of the annual accounts and the related documentation.
- monitoring the inspection carried out by external authorities.
- decisions related to the Company's remuneration policy
- decisions related to the implementation of Group level directives
- decisions related to subsidiaries

- Company decisions related to the purchase of Citibank's retail business in Hungary. and to the acquisitions by the EBRD and the Hungarian State in the Company.

2. Introduction to the members of the Board of Directors. the Supervisory Board and the Managing Board

2.1. *Members of the Board of Directors on 31 December 2016*

Jelasily Radován Chairman of the Board of Directors. CEO (01.06.2011. -)

Jelasily Radován was born in Baja. finished his secondary school in Budapest. He obtained an MBA at the Finance Faculty of Illinois University in Chicago. after having acquired a degree in economics at the Belgrade University. He started his banking career at the Deutsche Bank in Frankfurt where he worked for four years as area manager responsible for Central-Eastern Europe. Later he participated. on behalf of McKinsey&Company in Frankfurt in banking projects in Germany. Poland and Bulgaria. As Vice President of the Banking Rehabilitation Agency he participated in the reorganization of the banking sector and in the launch of the privatization process of several large banks. He was the Governor of the National Bank of Serbia between 2004 and 2010. and earlier he was Deputy Governor at the Serbian central bank. As central banker. he played an important role in the consolidation of the Serbian banking sector and the insurance market. as well as in the strengthening of the regulatory and supervisory bodies; furthermore he played a key role in Serbia's negotiations with international financial institutions. Jelasily Radován as Chief Executive Officer of ERSTE BANK HUNGARY Zrt. – since June 2011 – beyond his responsibilities specified by the laws and by the Board of Directors by-laws. the Chief Executive Officer acts for the good of the Bank's business policies. is responsible for financial stability. manages the Bank. helps the Board of Directors in making decisions affecting the entire Bank. contributes to setting directions to the Bank's business policies with evaluation of local and foreign business and macro-economic environment. He manages and coordinates the Bank's Corporate Division. supervises the division's strategic and business planning and operation.

László Harmati Executive Director. Deputy Retail CEO (02.04.2013. -)

The professional economist started his career at the ITCB - Consulting and Training. then between 1998 to 1999 he was Head of Department of Entrepreneurship and Regulation in the Ministry of Finance. Between 1999 and 2002. as Head of Department of Regulation at the National Bank of Hungary. he played a leading role. amongst others. in the development and launching of the domestic trading book regulation and the implementation of the Basel capital rules in Hungary. From 2002 until early 2013. as Deputy CEO at FHB Mortgage Bank Nyrt. and as CEO from 2010 the supervision of the entire business area was his competence. thus he played a leading role in the management of the bank's business strategy. In 2006-2007 he undertook an active role in founding the FHB Kereskedelmi Bank Zrt where he fulfilled the position of the CEO. In 2010 and 2011. during the acquisition of Allianz Bank Zrt he was in charge of the merger. he is associated with the establishment of the new business model. managing the rationalization project. and the intensive retail online developments (net-bank. netbroker. lead generation via the Internet). In 2012 he led several state schemes (NET. fixed exchange rate). He was a leading actor in the cost rationalization. the development of the new set of tools for housing subsidy. he is credited with the re-tuning of the collection protocols. and the increase of the branch and direct channels' cross-sale potential. László Harmati as Deputy CEO for Retail (Chief Retail Officer) of ERSTE BANK HUNGARY Zrt. – since April 2013 – manages and coordinates the retail division of the Bank. supervises the operation of the branch network. manages and supervises the sales of retail products and the customer service and telesales channel of the Bank.

Jurgen De Ruijter Executive Director. CRO. Deputy Risk management CEO (04.02.2015. -)

Jurgen De Ruijter has started his career in 2003 at ABN AMRO Bank NV in the Netherlands where he various positions in both retail and corporate segments. in loan portfolio management. From 2008 he continued his career in the ABN AMRO Bank in Romania as Corporate Loan Portfolio Management Director. In 2009 he moved to the Romanian Bank of Erste Group (BCR). where he filled in numerous management positions. He was in charge of Workout between 2009 and 2011. he was a Divisional Director at Remedial & Recovery business line from 2012 until January 2013. and as of January 2013 he was the CEO of the Workout Division. Jurgen De Ruijter as Deputy CEO for Risk Management (Chief Risk Officer) of ERSTE

BANK HUNGARY Zrt. – since February 2015 – supervises the credit policies of the Bank’s business lines, including the credit rating, collateral valuation and provisioning policies. He regularly reviews market risks, supervises the delegation of functions regarding credit clients and he holds responsibility for the safe and secure operation of the Bank, as well as for the legal activity of the entire Bank.

Ivan Vondra, Executive Director, CFO, Deputy Financial CEO (07.11.2015. -)

The economist professional used to work at the Czech subsidiary of the Erste Group, at Česká Sporitelna as Head of Accounting, Controlling and Business Intelligence since 2002. Before this he was also employed by a financial institution - between 1992 and 1996 he was Deputy CFO at International Commercial Bank, in Prague, thus he has a total of 20 years experience gained in the financial field. Ivan Vondra as Deputy CEO (Chief Financial Officer) of ERSTE BANK HUNGARY Zrt. –since November 2015 – is responsible for financial stability within the Bank’s business policies and he supervises the Finance and Accounting, Controlling, ALM and Facility and Property Management and Procurement areas.

Tamás Foltányi, Executive Director, COO, Deputy IT and Operation CEO (15.01.2016. -)

Studied in Budapest University of Technology at the Faculty of Electrical Engineering, Bank Management Programme at the The International Training Center for Bankers Ltd. (Bankárképző). During his working carrier he used to have leading positions at Inter-Európa Bank and Creditanstalt. From 1999 till 2004 as a managing partner at PWC and IBM he was responsible for the Hungarian financial sector and services offered for them, then took over the management of the IBM Global Services businesses. From 2005 till 2015 he used to be Deputy Chief Executive Officer of the FHB Jelzálogbank. Tamás Foltányi as Deputy CEO for IT and Operation (Chief Operating Officer) of ERSTE BANK HUNGARY Zrt. – since January 2016 - supervises the Bank’s system development and organization tasks, manages and coordinates the IT and investment planning in the Bank, cooperates in operative decision making and supports the Bank’s operation, holds responsibility for the Bank’s IT and operation.

Dr. János Rudnay, external Board of Directors member (01.10.2004. -)

He graduated at the Vienna University’ Law School in 1977. Between 1977 and 1994 he worked in management positions at various Philips affiliates. As of 1994 has was the CEO of the Pécs Brewery Rt. From 1995, he was the CEO of Reemtsma Debrecen Tobacco Plant Kft. Between 2001 and 2002 he was the member of SPB Investment Rt’s advisory body. He has been a consultant to Erste Group Bank AG since September 2002. From 4 December 2003 he was external Board member of Postbank and Savings Fund Rt, then from 1 October 2004 he has been external Board member of ERSTE BANK HUNGARY Zrt.

Frederik Silzer external Board of Directors member (01.08.2005. -)

He started his career in 1988 at the die Erste österreichische Spar-Casse Bank, then from 1993 he worked at AVABANK in the control of affiliates, he was Executive Director at several Central European subsidiaries. In 1998 he joined Bank Austria AG (earlier operated as Creditanstalt AG) where he was in charge of coordinating subsidiaries, amongst other in Hungary. Since 2008 he has been in charge of coordinating Erste Bank der österreichischen Sparkassen AG in Central-Eastern Europe, including Hungary. He is responsible for numerous acquisition and integration projects.

Krisztina Zsiga, external Board of Directors member (22.03.2016. -)

She graduated in 1993 at the Manchester Metropolitan University. She has been working in risk management for more than 14 years, and her career advanced in this area. She obtained numerous experiences in various European countries. Between 1995 and 2007 she worked in the Inter-Európa Bank, in Citibank and in the CitiGroup in Budapest, Moscow, Norway, Prague, and London. She joined Erste Group Bank AG in January 2008 where she has been working as Head of Retail Risk Management. Between 2013 and 2016 she was member of ERSTE Bank Hungary Zrt’s Supervisory Board, before she was elected as external Board member.

Zoltán István Marczinkó, external Board of Directors member (11.08.2016. -)

He graduated in 1988 at the Karl Marx University of Economic Sciences. At the beginning of his career he worked as the Head of Section for Production Organization in Dabas Printing House. He worked in the Budapest Bank Nyrt. as Lending Executive from 1992. Later he was the Head of Branch Network/Head of Central Branch at the HBW Express Savings Cooperative. He worked as the same position (branch manager) at the Budapest Bank from 2010 to the end of the year 2010. after that he was the head of the Corporate Business Center.

From 2013 he worked at the Széchenyi Kereskedelmi Bank Zrt. as Head of Acquisitions and Business Development. From 2014 he has been Deputy Secretary of State at the Ministry for National Economy. responsible for Key Corporate Relations.

Michael Neumayr. external Board of Directors member (14.09.2016. -)

He graduated as a lawyer in 1980 at the University of Vienna. He started his professional career in 1982 as manager at Girozentrale und Bank der österreichischen Sparkassen AG in Vienna. During his working career he used to have several positions at Girozentrale and subsidiary of Girozentrale from 1982 to 1994. He worked at GiroCredit Bank as Assistant General Manager and Head of the International Finance Department between 1990 and 1992. He was the Senior Vice President and Chairman of the Managing Board from 1992 to 1994. He began as Assistant General Manager and Head of the International Finance and Syndications Department at the Creditanstalt-Bankverein in the year 1995. He worked at the European Bank for Reconstruction and Development from 2002 to 2008.

Since 2008 he established his own company under the name of Finance and Business Consultant. From 2012 he is Board member at Krk-Kreditimi Rural I Kosoves (Kosovo). from 2015 at Unibank (Baku). and in addition member of GFF's Investment Committee.

2.2. *Members of Supervisory Board on 31 December 2016*

Dr. Manfred Wimmer. Supervisory Board member. Chairman of the Supervisory Board (01.09.2008. -)

He graduated in 1978 at the Law School of the Innsbruck University. His work experiences: 1982-1999: Creditanstalt. Wien. International Division. Since 1998 he has been working at ERSTE Bank der Oesterreichischen Sparkassen AG. between 1998-1999 as Head of International Marketing Department. between 1999-2002 as acquisition and integration Project Manager of Ceska Sporitelna. between 2002-2007 as Head of Strategic Holding Development Area. between 2007 and 2008 as President and Board Member of Banca Comerciala Romana. since 2008 as Board Member at Erste Group Bank AG responsible for Finance and Accounting and Performance Management. He retired as of 1 September 2013. keeping the Chairman position of the Company's Supervisory Board.

Friedrich Rödler. Supervisory Board member (28.04.2012. -)

He graduated in 1975 at the Vienna Technical University (Mathematics and IT specialty). then obtained an academic degree at the Vienna School of Economics in 1976. then a second degree in "International relations" specialty. From 1976 to 1986 he was employed by Arthur Andersen & Co. then between 1986 and 1990 he worked as a partner at GRT Robol & CO. He has been working at PWC Austria since 2000 in various positions. currently as Country Senior Partner. He has more than 34 years of work experience in financial. accounting and tax consultancy matters.

Gernot Mittendorfer. Supervisory Board member (02.12.2013. -)

He graduated at the Linz Law School in 1989. He started his career at the Erste Group in 1990 as Account Manager. From 1997 he joined Sparkasse Mühlviertel West Bank AG where he built the business in the Czech Republic as member of the Managing Board. In November 1999 he was moved to the Prague headquarter of Erste Group Bank AG where he was responsible for the retail area. As of 1 July 2000 he was appointed to member of Ceska Sporitelna's Managing Board. As of August 2004 he received a CEO mandate at the Salzburger Sparkasse Bank AG. then in 2007 at Ceska Sporitelna. Since January 2011 he has been a member of Erste Group Bank AG's Managing Board as Risk Management Director. As of September 2013 he is Finance Director at Erste Group Bank AG. and in this position he is responsible for the Group Accounting. Group Performance Management and Group Asset/Liability Management.

Maximilian Clary Und Aldringen. Supervisory Board member (22.03.2016. -)

He graduated at the Universitat Passau and European School of Management. He started his master's degree studies at London Business School for Executive MBA Degree in 2014. During his working career he used to have several positions at Raiffeisen Zentralbank Österreich AG and Raiffeisen Bank International AG. From 2013 to 2014 he was employed at the Romanian subsidiary of Erste Bank Bank AG. Banca Comerciala Romana. as a Chief Operating Officer consultant. Since April 2014. he had been the senior manager of the area. which is responsible for the group strategy of Erste Group Bank AG. and since January 2015 he has been the head of the mentioned area.

dr. Alíz Zsolnai. Supervisory Board member (11.08.2016. -)

She graduated in 2002 at the University of Szeged. She passed Specialist Exam in Public Administration in 2004. In 2006 she spent three month internship in the HM Treasury. She finished her PhD studies in 2012. From 2002 she is a Government official in the Ministry for National Economy. where she worked as Deputy Head of Department in 2014. and from 2015 as Head of Department.

Magdolna Nagy. Supervisory Board member. representing employees (01.02.2013. -)

She is Head of Custody Department

She graduated in 1990 at the Budapest School of Economics. She has 20 year experience in investment services. Since 1993 she developed the depository service activity in various domestic banks. Between 1993 and 1997. she was head of deposit management at Magyar Hitelbank. between 1997 and 2000 at CIB Közép-európai International Bank Rt; at ERSTE BANK HUNGARY Zrt she has been Head of Custody Department since 2000.

Márta Marosvölgyi. Supervisory Board member. representing employees (13.05.2013. -)

She is Head of the Operating Control within IT and Operation.

She has a chartered accountant degree; and she graduated in 2002 at the Budapest Business School as economist and controller. She started her professional career in 2002 as accountant at Colling Ltd. Between 2003-2007 she worked as an expert at Citibank Hungary and Citibank Handlowy/Warsaw/Poland (current accounts. deposits. loans. insurance and investments) within Operation. and she supported the conversion of the Core Bank System. Between 2007-2010 she worked at HSBC's Polish bank as Financial Control Manager. She joined ERSTE BANK HUNGARY Zrt. in 2010 as Head of Section at the Operation Control; since January 2011 she leads the Operations Control Department at the Company.

Anna Kósa. Supervisory Board member. representing employees (11.08.2016. -)

She is Head of Compliance and Fraud Prevention Department.

She graduated as lawyer in the University of Miskolc. She worked as compliance and legal executive at the beginning of her career at the Magyarországi Volksbank. She joined ERSTE BANK HUNGARY Zrt. in 2012 as compliance expert at the Aml and Securities Compliance. She was responsible for performance of compliance functions related to the financial and investment service activities of the Bank and supervision of the relevant internal processes from compliance aspects. Later she was the Acting Head of Department. She is the Head of Compliance and Fraud Prevention Department from May 2016.

2.3. *Members of Managing Board on 31 December 2016*

Jelasily Radován. Chairman of the Board of Directors. CEO. CFO. an executive manager responsible for the Corporate Business. **László Harmati.** Executive Director. Deputy CEO Retail

Jurgen De Ruijter Executive Director. Deputy Risk management CEO

Ivan Vondra Executive Director. CFO

Tamás Foltányi: Executive Director. Deputy CEO IT and Operation

3. Description of the number of meetings held by the Board of Directors and the Supervisory Board in 2016

In 2016 both the Board of Directors and Supervisory Board held four meetings each.

The quorum of the bodies at the 2016 meetings of the Board of Directors and the Supervisory Board was ensured in each case.

4. The presentation of viewpoints considered when evaluating the work of the Board of Directors, the Supervisory Board, the Managing Board, as well as of the different members

The Company is a credit institution subject to the Credit Institution Act, where, in line with the legislative provisions the Remuneration and Nomination Committee appraised the members of the Board of Directors and the Supervisory Board. The appraisal criteria for members of the Committees are set out in the Remuneration Policy published by the Company, and its Fit & Properregulation, and other criteria in the Credit Institution Act. No further measures were made as a follow-up to this appraisal.

5. Report on the operation of individual committees

5.1. Supervisory Board

The Supervisory Board carries out the tasks delegated to it by the law or the Company's Statutes, in particular:

- it ensures that the Company's operation is in line with the relevant laws and general rules, including the Statutes of the Company and the resolutions of the General Meeting;
- it is consulted on the annual financial report; verifies the Company's annual, interim (or other extraordinary) and consolidated balance sheets and the proposals for the distribution of dividends, furthermore it submits the related proposals to the General Meeting;
- the Supervisory Board will analyze the reports about the Company's management;
- before submitting it to the General Meeting, it forms an opinion on the draft amendments to the Statutes;
- it makes a proposal to the General Meeting on the person and remuneration of the auditor of the Company;
- the Supervisory Board will examine and assess the basic principles of the Company's business policy and forms an opinion on the Company's business policy;
- the Supervisory Board will inform the General Meeting of the outcome of its supervisory and other activities;
- the Supervisory Board will check the performance of the Company's Board of Directors;
- forms a preliminary opinion on the budget of the Company, as well as any decrease or increase of the budget items in excess of 10%;
- forms a preliminary opinion on the interim balance-sheet of the Company, required for interim dividend payment, or other reasons;
- grants a preliminary approval to the Board of Directors proposal on interim dividend payment (Section 3:263 (2) of the Civil Code);
- forms an opinion on the Investment Directives;
- forms a preliminary opinion on the Directives setting out the internal rules for the right of signing of persons assuming obligations on behalf of the Company, and on the disclosure principles;
- forms an opinion on the election of the Chairman of the Board of Directors and the executive managers;
- adopts and reviews the principles of the Remuneration Policy and it is responsible for its verification; and
- manages the organization of the Internal Audit;
- it develops recommendations and proposals on the basis of the findings of the examinations carried out by the Internal Audit.

The Supervisory Board consists of at least 3 and at most 9 members, elected for five years by the General Meeting. The members of the Supervisory Board can be re-elected and recalled by the General Meeting at any time. As long as the annual average number of the Company's FTE employees exceeds 200 people, one third of the Supervisory Board members are appointed by the General Meeting on the basis of the nomination by the Work Council. The mandate of members representing employees ceases upon the termination of his/her employment.

The Chairman of the Supervisory Board can be invited to the meetings of the Board of Directors in a consultative capacity.

The Supervisory Board meets as frequently as it deems necessary, or upon the request from any Supervisory Board member, but at least four times a year.

The invitation letters and the proposals concerning the matters to be discussed at the Supervisory Board's meeting must be sent to the members as set out in the by-laws.

The Supervisory Board meeting has a quorum when at least two-third of the Supervisory Board members are present, with at least three members present other than those elected upon the appointment from the Works Council.

The Supervisory Board passes its decisions with a simple majority and the open vote by the members present. The opinion of the employee representatives must be recorded in each case. Where the employee delegate's opinion is unanimously different from the Supervisory Board's majority opinion, the minority position of the employees must be disclosed to the General Meeting.

The Supervisory Board may pass its resolutions in writing, (including fax), teleconference or video conference, as set out in the by-laws.

As a rule, the documents related to the Supervisory Board meetings and resolutions are drawn up in English.

In 2016 the Supervisory Board resolutions affected primarily the following issues:

- Quarterly Board of Directors reports.
 - Remuneration Policy.
 - Matters related with the governance of the Internal Audit; and
 - the Company's organizational transformations.
 - Preparation of the Annual Report and the related report, making proposals.
 - making decisions related to the main changes related to subsidiaries.
 - Company decisions related to the purchase of Citibank's retail business in Hungary, and
 - to the acquisitions by the EBRD and the Hungarian State in the Company.

5.2. *Audit Committee*

The Audit Committee is a sub-committee of the Supervisory Board that carries out advisory and consultancy tasks to the Supervisory Board as set out in its by-laws, and performs other tasks as set out by the Supervisory Board. Under the by-laws, the Audit Committee is competent in the following matters, amongst others:

tasks related to the report under the Accounting Act, the audit made by the auditors, the person of the auditor and the contract to be concluded with it, the evaluation of the financial reporting system; furthermore the Audit Committee performs tasks related to the operation of internal control, such as the activities of the internal independent audit organization and proposes measures in connection with the risk assessment and risk management systems.

The Audit Committee consists of 3 members, elected by the General Meeting from the independent members of the Supervisory Board not representing employees. At least one member of the Audit Committee must have an accounting or auditing qualification.

The Audit Committee holds meetings as necessary but it must have a minimum of two meetings a year. The meeting is convened by the Chairman, or in his absence by the Deputy Chairman. The meeting of the Audit Committee must be convened if initiated by the Supervisory Board by specifying the purpose of the meeting.

The Audit Committee has a quorum if it is properly convened and at least two members are present. Otherwise the rules on the convention of the Supervisory Board apply. The Audit Committee passes its resolutions with unanimous decision.

The rules of the Audit Committee's operation are set out in its by-laws, adopted by the Supervisory Board. If all members of the Audit Committee agree, its meeting can be convened electronically, via fax or the phone.

The Audit Committee may pass its resolutions by phone, fax or in any similar way.

The Chairman, or in the absence of the Chairman the Deputy Chairman makes an oral presentation to the Supervisory Board on the activity performed by or the meetings of the Audit Committee since the last oral or written report. Regular reports must be drawn up on the meeting of the Audit Committee and annexed to the material of the Supervisory Board meetings.

In 2016, the Audit Committee held four meetings, at all of them the Committee had a quorum.

In 2016 the Audit Committee primarily passed decisions on internal audit, the inspections carried out by the NBH at the Company, with the annual report and the auditor. The Board of Directors made no resolutions against the proposal from the Committee.

Members of the Audit Committee on 31 December 2016

Friedrich Roller, Chairman

Gernot Mittendorfer, Deputy Chairman

Maximilian Clary Und Aldringen, member

5.3. *Risk Governance Committee*

The Risk Governance Committee is responsible for examining the reports related to the Company's risk profile, the risk management framework and risk management processes, and to supervise continuously the Company's solvency positions and compliance with the legislation and Erste Group level standards. It examines pricing principles, reviews remuneration guidelines in the context whether they comply with the institution's risk, capital and liquidity positions and the expected revenues.

The Committee receives information on every relevant development in risk management, reviews and discusses portfolio reports, and reports prepared on the risk management framework and related processes.

Three members of the Committee are delegated from amongst the external Board of Directors members.

Any member of the Board of Directors or the Supervisory Board, and the Deputy CEO Risk Management (Head of CRO, risk management areas in EBH) can also participate at the Committee's meetings but with no voting right, however, he/she can participate in the debates. Where the matters to be discussed require, the Chairman, or in his absence the Deputy Chairman can invite other Company employees or experts with appropriate expertise, to attend the Committee meeting with no voting right

The Risk Governance Committee holds its meetings as required but at least four times a year.

The Risk Governance Committee has a quorum if it is convened properly and at least two members are present. To pass a resolution on any matter discussed at the Committee's meeting at least two members voting for the decision is required. The members participating at the meeting via a teleconference or a video conference must be considered attending members.

The Risk Governance Committee may pass its resolutions via the phone, fax or other similar ways.

The Chairman, or in his absence the deputy Chairman reports the Board of Directors on the activities completed by the Committee since the previous oral report and the meetings held. The Committee reports regularly to the Supervisory Board on its activities.

In 2016, the Risk Governance Committee held four meetings, at all of them the Committee had a quorum.

In year 2016 the Committee dealt with the matters within its competence, the amendment of risk management policies, and the effects of external events relevant for risk management.

Members of the Risk Taking - Risk Management Committee on 31 December 2016

Krisztina Zsiga, Chairwoman

Frederik Silzer, Deputy Chairman

dr. János Rudnay

5.4. *Remuneration and Nomination Committee*

The Remuneration and Nomination Committee performs the tasks specified in the Credit Institution Act for the Remuneration and Nomination Committee, as set out in its by-laws.

The Remuneration and Nomination Committee has three members, its members are delegated from amongst the external members of the Board of Directors.

The Committee's by-laws sets out members of bodies, and employees that can attend the meetings of the Committee in consultative capacity. Depending on the agenda items, further guests, the Company's employees and external experts can be invited to the meetings of the Remuneration and Nomination Committee.

The Committee shall meet as required but at least twice a year. The Committee's meeting must be convened if initiated by any of its members by specifying the purpose of the meeting.

The Committee may pass its resolutions by phone, fax or in any similar way.

The Committee has a quorum if at least two of its members are present. The Committee can pass decisions in any matter discussed at the meeting if at least two members vote for it. Members participating at a meeting by conference call or video conference shall be considered as being present.

In 2016 the Remuneration and Nomination Committee held two meetings; at both meetings the Committee had a quorum.

In 2016 the Committee mainly dealt with changes in the top management, remuneration issues, tasks within the Remuneration and Nomination Committee's competence and matters related to the amendment of the Remuneration Policy.

Members of the Remuneration and Nomination Committee on 31 December 2016:

dr. János Rudnay, Chairman

Frederik Silzer, Deputy Chairman

Krisztina Zsiga

6. Presentation of the system of internal controls and evaluation of the activity in the relevant period

The Company established and ensured at group level the system of internal controls, in line with the Credit Institution Act and the recommendation from MNB, and laid it down in the Company by-laws. The primary goal for operating internal controls is to facilitate the Company's prudent, efficient operation, in compliance with the legislation and by-laws, furthermore to assist the Company management in substantiated decision-making.

The basic pillars to the Company's internal control functions are the risk control function (risk management), compliance control function (compliance) and internal audit function. In the context of the financial process the work of the standing auditor is part of the internal control.

Internal Audit

The internal audit performs examination and evaluation of the activities of the Company and the subsidiaries and ancillary businesses subject to consolidated supervision with the Company. In this context it monitors compliance with legislative requirements, official orders and bylaws, whether the Company avails of the by-laws provided for by legislation and ensuring prudent operation, whether organizational units operate as provided for in the strategic objectives, it verifies the compliance and operation of business records, the outsourced activities and the content of the Remuneration Policy. As preventive activity, it contributes to projects as advisor, and forms an opinion when new products, by-laws, systems are introduced, if necessary.

The Internal Audit reports to the Supervisory Board, the Audit Committee and forward the reports to the Managing Board and the Board of Directors of the Company, and ensures that the reports are available to the financial supervisory authority. The annual report of the Internal Audit on the implementation of the remuneration policy is also forwarded to the Remuneration and Nomination Committee.

The Supervisory Board governs the system of the independent internal audit and during this:

- it ensures that the Company has a comprehensive control system in place that is suitable for the effective operation.
- it adopts the annual audit plan of the internal audit organizational unit.
- It discusses at least half yearly the reports prepared by the internal audit and verifies the implementation of the required measures.
- if necessary, it assists the work of the internal audit by engaging an external expert.
- it makes proposals to change the headcounts of the internal audit organizational unit.

The Supervisory Board develops recommendations and proposals on the basis of the findings of the examinations carried out by the Internal Audit.

Decisions related to the establishment of an employment of the Head of Internal Audit, and his dismissal by the employer can be passed with the preliminary consent from the Supervisory Board.

Audit Committee

The sub-committee of the Supervisory Board, the Audit Committee also performs tasks related to the operation of the internal control system and the activities of the independent internal audit system, amongst others:

- discusses all internal audit related material prepared for the Supervisory Board.

- makes proposals for the Supervisory Board on the appointment, dismissal of the head of internal audit, the organization, headcount and main operational rules of the internal audit.
- makes proposals to the Supervisory Board in connection with the annual audit plan and the outcome of the internal audit activity, and
- proposes measures in the context of risk assessment and management systems.

Anti money-laundering and Compliance

The Anti-money laundering, the Compliance and Fraud Prevention areas of the Company carry out tasks related to the prevention of money laundering, international sanctions and fraud management and compliance risk detection and management tasks, on the basis of European Union and domestic legislation. In this context they draw up by-laws and procedures compliant with domestic and international legislation; in connection with their activities they perform inquiries and audits; perform similar professional supervision of group subsidiaries.

These areas of the Company prepare an annual comprehensive report on the anti money-laundering and compliance activity and state, to be approved by the Board of Directors of the Company.

Risk Management

The Company's risk management system is established to comply with legislative and supervisory requirements, in addition to the internal objectives of efficient and effective risk management. This system includes risk identification, the evaluation and analysis of their effects, drawing up plans for the required measures, and monitoring the efficiency of the risk management system. The management of the Company passes its resolutions being aware of significant risks.

Apart from the Risk Governance Committee, the Company set up further committees in order to ensure support to efficient decision making process and the multi-functional supervision (joint participation of various professional areas). Their main purpose is to establish risk management, the related principles, risk strategy and its alignment with the business strategy, its follow-up and monitoring, and to increase risk awareness. Among the key objectives of these committees are the implementation of mutual coordination between corporate and retail lending functions and internal management functions.

Risk management standards and expectations are set out in detail in the Company's risk management by-laws.

The Company publishes its Disclosure Report pursuant to the Capital Requirements Regulations ("Risk Management report") on its website each year, containing the organizational structure of risk management and the relevant risk management information at the Company in the relevant year, and the risk factors influencing the Company's operation and management. The Risk Management report can be accessed here at the Company website (www.erstebank.hu): *Bankunkról/Erste Bank Hungary Zrt./Vállalatirányítás/Közzetételek/2017-es hivatalos közzétételek*

Standing auditor

The Company has a standing auditor, appointed by the General Meeting, and registered in the Company Register.

The Company engaged with the audit of its 2016 annual report and consolidated annual report in line with the legislation in force Ernst & Young Kft. (1132 Budapest, Váci út 20.). Appointed auditor: Gergely Szabó (mother's name: Zsuzsanna Kiss, 1202 Budapest, Mézes u. 35. Registration number with the Chamber: 005676.)

The auditor performs its other tasks specified by the law (in particular in the Credit Institution Act); furthermore the Board of Directors and the Supervisory Board can request the auditor to perform special inspections and to draw up a report on them.

The Company regularly presents, in the Notes to the Annual Accounts, the fees charged by the auditor for the other certification services, for tax consultancy and other non-audit services charged in the reporting year (in addition to the fee charged by the auditor for the audit of the reports of the reporting year).

7. The company's disclosure policy

The Company is a private limited company that lays down its publication principles and procedures in its by-laws, in accordance with the legislative provisions. The by-laws set out principles and procedures which ensure that all relevant information about the Company and circumstances influencing its share price are disclosed accurately, in a timely fashion and in full.

- The Company regularly presents, in the Notes to the Annual Accounts, the fees charged by the auditor for the other certification services, for tax consultancy and other non-audit services charged in the reporting year (in addition to the fee charged by the auditor for the audit of the reports of the reporting year).
- The Company publishes its Risk Management report on its website each year, containing the organizational structure of risk management and the relevant risk management information at the Company in the relevant year, and the risk factors influencing the Company's operation and management.
- The Company publishes, together with its annual report, on its website the main remuneration data for the previous years, furthermore the summary of its current remuneration policy is available on its website.
- In its annual report the Company discloses information on the professional career of the members of the Board of Directors, the Supervisory Board and the Managing Board.

8. The Company's policy on trading by insiders

The Company is a private limited company, which manages the list of insider traders in line with the provisions of the Capital Market Act³ **and establishes its by-laws on insider trading.**

9. Method of exercising shareholders' rights

The Company's main body is the General Meeting, where shareholders can exercise their participation and voting rights in person or via proxy.

The General Meeting is convened by the Board of Directors. The convention of the General Meeting can be initiated by one or several Shareholders or any Supervisory Board member in writing; its decision can be also initiated by the competent authority, the auditor and the court of registration. Invitation to the General Meeting is sent by the Board of Directors in writing (via the post, fax or, upon an express request, e-mail) to the Shareholders, at least thirty days before the date of the meeting.

The General Meeting can be attended via telecommunication devices (phone, videophone, online conference devices), in line with the rules set out in the Statutes.

The General Meeting can also pass resolutions in writing, without holding a meeting. In such a case a resolution is adopted when the last vote required to pass a resolution is received by the Board of Directors, provided that it is received within 30 days after the sending out of the draft resolution. Any Shareholder can request the convention of a face-to-face General Meeting within five working days following the receipt of the draft resolutions.

The General Meeting shall have a quorum if the Shareholders holding more than 75% of votes are present. A second or further General Meeting can be convened to a date at least three working days after the general meeting without a quorum.

³ Act CXX of 2001 on the Capital Market

with the same agenda; in this case the General Meeting has a quorum where at least Shareholders holding at least 50% of the votes are present.

The General Meeting decides in matters belonging into his competence under legislation and the Statutes. The following are the exclusive competence of the General Meeting:

- amendments to the Statutes;
- increasing the share capital;
- appointment, dismissal, and setting the remuneration of the members of the Board of Directors;
- the election and dismissal of the members of the Supervisory Board or the Company's auditor, and establishing their remuneration;
- the election and dismissal of the members of the Audit Committee;
- adoption of the reports (activity report from the Board of Directors on the previous year's business, and the Supervisory Board's report on such a report), including the resolution on the use of the profit after tax;
- evaluation of the Board of Directors member's work in the previous business year, decision on the discharge to the Board members;
- decision to pay dividends and interim dividends;
- return of the Company's license for the activity;
- approval of the Supervisory Board's by-laws; and
- making decisions on all issues assigned to the competence of the General Meeting by law or the Statutes.

In the General Meeting's decision making voting procedures set out in the Civil Code⁴ apply, except if any of these matters belong to the Reserved Competence of the General Meeting as set out in the Statutes, in which case the special voting rules as set out in the Statutes apply.

10. Remuneration statement

The Company publishes, together with its annual report, on its website the main remuneration data for the previous years, furthermore the summary of its current remuneration policy is available on its website.

The summary of the Remuneration Policy can be accessed here at the Company website (www.erstebank.hu):
<https://www.erstebank.hu/hu/bankunkrol/erste-bank-hungary-zrt/javadalmasasi-politika>

II. PART

Corporate Governance Report on Compliance with the Corporate Governance Recommendations

As part of the Corporate Governance Report, by completing the following tables, **the Company declares to what extent it applied in its own practice of corporate governance the recommendations and suggestions formulated in the different points of the CGR published by the Budapest Stock Exchange Ltd.**

By reviewing the tables, market participants may receive information on the extent to which the corporate governance practice of different companies meets certain requirements included in the CGR, and may easily compare the practices of the different companies.

Level of compliance with the Recommendations

The Company should indicate whether it applies the relevant recommendation or not, and in the case of a negative answer, it should provide the reasons for not applying the given recommendation.

A 1.1.1 The Board of Directors / Governing Body ensured that shareholders received access to information in time to enable them to exercise their rights.

⁴ Act V of 2013 on the Civil Code of Hungary

Yes (Complies)

No (Explanation)

A 1.1.2 The company applies the "one share - one vote" principle.

Yes (Complies)

No (Explanation)

A 1.2.8 The company ensures that shareholders must meet the same requirements in order to attend at the general meeting.

Yes (Complies)

No (Explanation)

A 1.2.9 Items on the general meeting agenda only include subjects which are correctly detailed and summarized clearly and unambiguously.

Yes (Complies)

No (Explanation)

The proposals included the suggestions of the Supervisory Board and a detailed explanation of the effects of the decision.

Yes (Complies)

No (Explanation)

A 1.2.10 Shareholders' comments on and supplements to the items on the agenda were published at least two days prior to the general meeting.

Yes (Complies)

No (Explanation)

The Company is a private limited company. for which no legislative provision for such publication exists. due to the special characteristics of the operational form.

A 1.3.8 Comments on the items of the agenda were made available to shareholders simultaneously with registration at the latest.

Yes (Complies)

No (Explanation)

The Company is a private limited company. for which no such legislative provision exists. due to the special characteristics of the operational form. In this year no shareholder comments were received to the agenda items of the General Meeting.

Written comments made on the items on the agenda were published two working days prior to the general meeting.

Yes (Complies)

No (Explanation)

The Company is a private limited company. for which no legislative obligation for such publication exists. due to the special characteristics of the operational form.

A 1.3.10 The election and dismissal of executives took place individually and by separate resolutions.

Yes (Complies)

No (Explanation)

A 2.1.1 The responsibilities of the Board of Directors / Governing Body include those laid out in Section 2.1.1 of CGR.

Yes (Complies)

No (Explanation)

The Company is subject to the Credit Institution Act. which delegates the task under Subsection 2.1.1. d) of CGR. in accordance with the Remuneration Policy of the Company. to the Remuneration and Nomination Committee. otherwise the Board of Directors' tasks cover Section 2.1.1.

A 2.3.1 The Board of Directors / Governing Board held meetings regularly. at times designated in advance.

Yes (Complies)

No (Explanation)

The Supervisory Board held meetings regularly. at times designated in advance.

Yes (Complies)

No (Explanation)

The rules of procedure of the Board of Directors / Governing Board provide for unscheduled meetings and decision-making through electronic communications channels.

Yes (Complies)

No (Explanation)

The rules of procedure of the Supervisory Board provide for unscheduled meetings and decision-making through electronic communications channels.

Yes (Complies)

No (Please explain)

A 2.5.1 The Governing Board / Supervisory Board of the company has a sufficient number of independent members to ensure the impartiality of the board.

Yes (Complies)

No (Explanation)

No Governing Board operates at the Company. The members of the Supervisory Board are independent of the management of the Company.

A 2.5.4 At regular intervals (in connection with the CGR) the Governing Board / Supervisory Board requested a confirmation of their independent status from those members considered independent.

Yes (Complies)

No (Explanation)

No Board of Directors operates at the Company.

A 2.5.6 The company disclosed on its website the guidelines on the independence of the Governing Board / Supervisory Board. as well as the criteria applied for assessing independence.

Yes (Complies)

No (Explanation)

The Company is a private limited company. for which no legislative obligation for such disclosure obligation exists. due to the special characteristics of the operational form.

A 2.6.1 Members of the Board of Directors / Governing Board informed the Board of Directors / Governing Board (Supervisory Board/Audit Committee) if they (or any other person in a close relationship to them) had a significant personal stake in a transaction of the company (or the company's subsidiary).

Yes (Complies)

No (Explanation)

A 2.6.2 Transactions between board and executive management members (and persons in close relationship to them) and the company (or its subsidiary) were conducted according to general rules of practice of the company. but with stricter transparency rules in place.

Yes (Complies)

No (Explanation)

Transactions which according to 2.6.2. fell outside the normal course of the company's business. and their terms and conditions were approved by the Supervisory Board.

Yes (Complies)

No (Explanation)

The Company is a company subject to the Credit Institution Act. and according to this legislation. transactions concluded between the members of the bodies and the management (and persons related to them) and the

Company (and its subsidiaries) are approved by the body/bodies specified by the by-laws. established in line with the requirements of the Credit Institution Act on internal lending and conflict of interests (decision of the Company's Board of Directors and the consent decision by the Supervisory Board. and of the subsidiary's Board of Directors and/or Supervisory Board).

A 2.6.3 Board members informed the Supervisory Board/Audit Committee (nomination committee) if they received an offer of Board membership or an offer of an executive management position in a company which is not part of the company group.

Yes (Complies)

No (Explanation)

Pursuant to Sections 143-145 of the Credit Institution Act. any member of the Board of Directors shall immediately notify the Company Secretariat if he/she establish or terminate a membership in the management or any of the bodies of a company which is not a member of the Erste group. Such notification is examined by Compliance - in line with Section 13.12. of the Statutes of the Company and other by-laws - for potential conflicts of interests. and in the event of establishing the existence of the conflict of interests it calls the person concerned. by setting an appropriate deadline. to resolve the conflict of interest.

A 2.6.4 The Board of Directors / Governing Body established its guidelines on information flow within the company and the handling of insider information. and monitored compliance with those guidelines.

Yes (Complies)

No (Explanation)

The Board of Directors / Governing Body established its guidelines regarding insiders' trading in securities and monitored compliance with those guidelines.

Yes (Complies)

No (Explanation)

A 2.7.1 The Board of Directors / Governing Body formulated remuneration guidelines regarding the evaluation and remuneration of the work of the Board of Directors / Governing Body. the Supervisory Board and the executive management.

Yes (Complies)

No (Explanation)

The Company is a company subject to the Credit Institution Act. and in line with the requirements of that legislation the principles of the Company's Remuneration Policy are adopted and reviewed by the Supervisory Board. In line with the legislative provisions the Remuneration and Nomination Committee appraised the members of the Board of Directors and the Supervisory Board.

The Supervisory Board formed an opinion on the remuneration guidelines.

Yes (Complies)

No (Explanation)

The Company is a company subject to the Credit Institution Act. and in line with the requirements of that legislation the principles of the Company Remuneration Policy are adopted and reviewed by the Supervisory Board.

The guidelines regarding the remuneration for the Board of Directors / Governing Body and the Supervisory Board and the changes in those guidelines were approved by the general meeting. as a separate item on the agenda.

Yes (Complies)

No (Explanation)

The Company is a company subject to the Credit Institution Act. and in line with the requirements of that legislation the principles of the Company Remuneration Policy are adopted and reviewed by the Supervisory

Board and the Remuneration and Nomination Committee makes separate decisions on the remunerations of the members of the Board of Directors and Supervisory Board.

A 2.7.2 The Board of Directors / Governing Body prepared an evaluation of the work it carried out in the given business year.

Yes (Complies)

No (Explanation)

The Company is a company subject to the Credit Institution Act. and in line with the requirements of that legislation the appraisal of the Board of Directors' members work and performance is the responsibility of the Remuneration and Nomination Committee.

A 2.7.2.1 The Supervisory Board prepared an evaluation of the work it carried out in the given business year.

Yes (Complies)

No (Explanation)

The Company is a company subject to the Credit Institution Act. and in line with the requirements of that legislation the appraisal of the Supervisory Board's members work and performance is the responsibility of the Remuneration and Nomination Committee.

A 2.7.3 It is the responsibility of the Board of Directors / Governing Body to monitor the performance of and determine the remuneration for the executive management.

Yes (Complies)

No (Explanation)

The frameworks of benefits due to members of the executive management that do not represent normal practice. and the changes in those benefits were approved by the general meeting as a separate agenda item.

Yes (Complies)

No (Explanation)

The Company is a company subject to the Credit Institution Act. and in line with the requirements of that legislation the frameworks of the remuneration applied by the Company and different from the usual are adopted and reviewed by the Remuneration and Nomination Committee. within the framework set by the principles of the Remuneration Policy.

A 2.7.4 The structure of share-incentive schemes were approved by the general meeting.

Yes (Complies)

No (Explanation)

In year 2016 no share-incentive scheme existed at the Company.

Prior to the decision by the general meeting on share-incentive schemes. shareholders received detailed information (at least according to those contained in 2.7.4).

Yes (Complies)

No (Explanation)

In year 2016 no share-incentive scheme existed at the Company.

A 2.7.7 The Remuneration Statement was prepared by the company and submitted to the general meeting.

Yes (Complies)

No (Explanation)

The Company's Remuneration Policy is approved by the Supervisory Board. in line with the requirements of the Credit Institution Act. the summary of which is published by the Company. Furthermore. the Company prepares. under the CRR⁵. and publishes in the framework of the Risk Management report its remuner-

⁵ Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (CRR)

ation data for the reporting year; the Risk Management report is approved by the Managing Board of the Company.

The Remuneration Statement includes information about the remuneration of individual members of the Board of Directors / Governing Body, the Supervisory Board, and the executive management.

Yes (Complies)

No (Explanation)

The Company prepares, under the CRR, and publishes in the framework of the Risk Management report its remuneration data for the reporting year regarding employees having significant effects on the risk profile of the Company (key persons); it contains remuneration data on an aggregate basis.

A 2.8.1 The Board of Directors / Governing Body or the committee operated by it is responsible for monitoring and controlling the company's entire risk management.

Yes (Complies)

No (Explanation)

The Company, as a credit institution with at least 5 percent market share in terms of its balance sheet total, has a Risk Governance Committee established in line with the Credit Institution Act.

The Board of Directors / Governing Body request information on the efficiency of risk management procedures at regular intervals.

Yes (Complies)

No (Explanation)

The Board of Directors / Governing Body took the necessary steps to identify the major risk areas.

Yes (Complies)

No (Explanation)

A 2.8.3 The Board of Directors / Governing Body formulated the principles regarding the system of internal controls.

Yes (Complies)

No (Explanation)

Risk control function, compliance control function and internal audit function can be classified as internal control functions. The system of internal controls, and the principles related to that system are established in accordance with the Credit Institution Act and Recommendation No. 6/2014 (XII. 17.) of MNB, approved by the bodies provided for in the by-laws and legislation. The bank level framework of risk control function and the application of risk taking principles (identification, measuring, mitigation, monitoring) and the rules of determination of risk bearing capacity calculation were defined within the framework of enterprise-wide risk management which was approved by the management and Board of Directors of the Company. The Compliance internal regulation comprising the provisions of compliance control function is to be approved by the management of the Company. Regarding internal audit system please see Sections 5.1., 5.2. and 6 of this corporate governance report.

The system of internal controls established by the executive management guarantees the management of risks affecting the activities of the company, and the achievement of the company's performance and profit targets.

Yes (Complies)

No (Explanation)

A 2.8.4 When developing the system of internal controls, the Board of Directors / Governing Body took into consideration the viewpoints included in 2.8.4.

Yes (Complies)

No (Explanation)

A 2.8.5 It is the duty and responsibility of the executive management to develop and maintain the system of internal controls.

Yes (Complies)

No (Please explain)

Within the framework set out in the Credit Institution Act.

A 2.8.6 The company created an independent Internal Audit function which reports to the Audit Committee / Supervisory Board.

Yes (Complies)

No (Explanation)

The Internal Audit reported at least once to the Audit Committee / Supervisory Board on the operation of risk management, internal control mechanisms and corporate governance functions.

Yes (Complies)

Regarding reporting of Internal Audit please see Section 6 of this corporate governance report.

A 2.8.7 The internal audit activity is carried out by the Internal Audit function based on authorization from the Audit Committee / Supervisory Board.

Yes (Complies)

No (Explanation)

As an organization, the Internal Audit function is independent from the executive management.

Yes (Complies)

No (Explanation)

A 2.8.8 The Internal Audit schedule was approved by the Board of Directors / Governing Body (Supervisory Board) based on the recommendation of the Audit Committee.

Yes (Complies)

No (Explanation)

Under the Credit Institution Act, the internal audit plan is adopted by the Supervisory Board.

A 2.8.9 The Board of Directors / Governing Body prepared its report for shareholders on the operation of internal controls.

Yes (Complies)

No (Explanation)

The operation of internal controls established in line with the Credit Institution Act is audited by the Internal Audit; the supervision of the Internal Audit is the competence of the Supervisory Board. Risk control and compliance control are subject to the governance by the member of the Company's risk management Board member (Deputy CEO Risk Management), which areas regularly report to the Board of Directors, to the Supervisory Board, and to the Managing Board.

The Board of Directors / Governing Body developed its procedures regarding the receipt, processing of reports on the operation of internal controls, and the preparation of its own report.

Yes (Complies)

No (Explanation)

The Internal Audit, and in the cases specified in the Credit Institution Act, the Supervisory Board is responsible for developing the procedures related to the reports on internal controls in accordance with the Credit Institution Act.

A 2.8.11 The Board of Directors / Governing Body identified the most important deficiencies or flow in the system of internal controls, and reviewed and re-evaluated the relevant activities.

Yes (Complies)

No (Explanation)

A 2.9.2 The Board of Directors / Governing Body, the Supervisory Board and the Audit Committee were notified in all cases when an assignment given to the auditor may have resulted in significant additional expense, caused a conflict of interest, or affected normal business practices significantly in any other way.

Yes (Complies)

No (Explanation)

A 2.9.3 The Board of Directors / Governing Body informed the Supervisory Board of any assignment given to the external auditor or an external advisor in connection with any event which held significant bearing on the operations of the company.

Yes (Complies)

No (Explanation)

The Board of Directors / Governing Body pre-determined in a resolution what circumstances constitute "significant bearing" on the operation of the Company.

Yes (Complies)

No (Explanation)

The Company classifies economic transactions as „significant bearing” actions according to the finance ministry decree of 24/2008. (VIII. 15.).

A 3.1.6 On its website, the company disclosed duties delegated to the Audit Committee, as well as the committees targets, rules of procedure, composition (indicating the name, brief biography and the date of appointment of members).

Yes (Complies)

No (Explanation)

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes significant part of the above data in this Corporate Governance Report.

A 3.1.6.1 On its website, the company disclosed duties delegated to the Nomination Committee, as well as the committees targets, rules of procedure, composition (indicating the name, brief biography and the date of appointment of members).

Yes (Complies)

No (Explanation)

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes significant part of the above data in this Corporate Governance Report.

A 3.1.6.2 On its website, the company disclosed duties delegated to the Remuneration Committee, as well as the committees targets, rules of procedure, composition (indicating the name, brief biography and the date of appointment of members).

Yes (Complies)

No (Explanation)

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes significant part of the above data in this Corporate Governance Report.

A 3.2.1 The Audit Committee / Supervisory Board monitored the efficiency of risk management, the operation of internal controls, and the activity of the Internal Audit.

Yes (Complies)

No (Explanation)

A 3.2.3 The Audit Committee / Supervisory Board received accurate and detailed information on the work schedule of the Internal Auditor and the independent auditor. and received the auditor's report on problems discovered during the audit.

Yes (Complies)

No (Explanation)

A 3.2.4 The Audit Committee / Supervisory Board requested the new candidate for the position of auditor to submit the disclosure statement according to 3.2.4.

Yes (Complies)

No (Explanation)

A 3.3.1 There is a Nomination Committee operating at the company.

Yes (Complies)

No (Explanation)

A 3.3.2 The Nomination Committee provided for the preparation of personnel changes.

Yes (Complies)

No (Explanation)

The Nomination Committee reviewed the procedures regarding the election and appointment of members of the executive management.

Yes (Complies)

No (Explanation)

The Nomination Committee evaluated the activity of board and executive management members.

Yes (Complies)

No (Explanation)

The Nomination Committee examined all the proposals regarding the nomination of board members which were submitted by shareholders or the Board of Directors / Governing Body.

Yes (Complies)

No (Explanation)

The Remuneration and Nomination Committee examines, in accordance with the Credit Institution Act, the nomination of Board of Directors members, Executive Directors and Supervisory Board members.

A 3.4.1 There is a Remuneration Committee operating at the company.

Yes (Complies)

No (Explanation)

A 3.4.2 The Remuneration Committee made a proposal for the system of remuneration for the boards and the executive management (individual levels and the structure of remuneration). and carries out its monitoring.

Yes (Complies)

No (Explanation)

A 3.4.3 The remuneration of the executive management was approved by the Board of Directors / Governing Body based on the recommendation of the Remuneration Committee.

Yes (Complies)

No (Explanation)

The remuneration of the Board of Directors / Governing Body was approved by the general meeting based on the recommendation of the Remuneration Committee.

Yes (Complies)

No (Explanation)

In accordance with the requirements of the Credit Institution Act. the employer's rights with regard to Executive Directors are exercised by the Board of Directors of the Company; the remuneration of the Board of Directors members is approved by the General Meeting.

The Remuneration Committee also monitored the share option. cost reimbursement and other benefits in the remuneration system.

Yes (Complies) No (Explanation)

A 3.4.4 The Remuneration Committee made proposals regarding remuneration guidelines.

Yes (Complies) No (Explanation)

A 3.4.4.1 The Remuneration Committee made proposals regarding the remuneration of individual persons.

Yes (Complies) No (Explanation)

A 3.4.4.2 The Remuneration Committee reviewed the terms and conditions of contracts concluded with the members of the executive management.

Yes (Complies) No (Explanation)

A 3.4.4.3 The Remuneration Committee ascertained whether the company fulfilled its disclosure obligations regarding remuneration issues.

Yes (Complies) No (Explanation)

A 3.4.7 The majority of the members of the Remuneration Committee are independent.

Yes (Complies) No (Explanation)

The Company is a credit institution subject to the Credit Institution Act whose Remuneration and Nomination Committee is established with the composition set out by the law. and its members are delegated from amongst the external members of the Board of Directors (who are not in employment relationship with the Company).

A 3.5.1 The Board of Directors / Governing Body disclosed its reasons for combining the Remuneration and Nomination Committees.

Yes (Complies) **No (Explanation)**

The Credit Institution Act applicable to the Company does not provide for a publication on the justified nature of this combination.

A 3.5.2 The Board of Directors / Governing Body carried out the duties of the Nomination Committee and disclosed its reasons for doing so.

Yes (Complies) **No (Explanation)**

There is a Remuneration and Nomination Committee operating at the Company.

A 3.5.2.1 The Board of Directors / Governing Body carried out the duties of the Remuneration Committee and disclosed its reasons for doing so.

Yes (Complies) **No (Explanation)**

There is a Remuneration and Nomination Committee operating at the Company.

A 4.1.1 In its disclosure guidelines, the Board of Directors / Governing Body established those principles and procedures which ensure that all relevant information about the operations of the company and circumstances influencing its share price are disclosed and made available accurately, in a timely fashion and in full.

Yes (Complies)

No (Explanation)

The Company is a private limited company, and its sets out its disclosure principles and procedures in accordance with the laws (primarily the Civil Code, the Credit Institution Act, the Capital Markets Act⁶, Act on Investment Services⁷, Act C of 2000 on Accounting and Decree 24/2008 (VIII.15.) of the Minister of Finance) in its by-laws, ensuring that all material information affecting the price of its securities is disclosed precisely, fully and in a timely manner.

A 4.1.2 The company ensured in its disclosure activities that all shareholders and market participants were treated equally.

Yes (Complies)

No (Explanation)

The Company is a private limited company, where arrangement made by the three Shareholders of the Company and the provisions of the Statutes apply, regarding disclosure towards market participants please see Section 7 of present Corporate Governance Report.

A 4.1.3 The company's disclosure guidelines include the procedures governing electronic, on-line disclosure.

Yes (Complies)

No (Explanation)

The company develops its website taking into consideration disclosure guidelines and the provision of information to investors.

Yes (Complies)

No (Explanation)

The Company is private credit institution, who develops its website in line with its ownership structure, by keeping in mind the disclosure principles in accordance with the standards in the Credit Institution Act and the Act on Investment Services and the proper information of customers and investors.

A 4.1.4 The Board of Directors / Governing Body assessed the efficiency of disclosure processes.

Yes (Complies)

No (Explanation)

A 4.1.5 The company published its corporate events calendar on its website.

Yes (Complies)

No (Explanation)

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes the material content of resolutions passed by the General Meeting.

A 4.1.6 In the annual report and on the website of the company, the public was informed about the company's corporate strategy, its main business activities, business ethics and its policies regarding other stakeholders.

Yes (Complies)

No (Explanation)

⁶ Act CXX of 2001 on Capital Markets

⁷ Act CXXXVIII of 2007 on investment companies and commodity exchange service providers as well as on the rules of the activities to be carried out by them

A 4.1.8 In the annual report the Board of Directors / Governing Body disclosed the character and size of any other assignments given by the company or its subsidiaries to the auditing firm responsible for auditing the financial statements.

Yes (Complies)

No (Explanation)

A 4.1.9 In the annual report and on the website the company discloses information on the professional career of the members of the Board of Directors / Governing Body, the Supervisory Board and the executive management.

Yes (Complies)

No (Explanation)

A 4.1.10 The company provided information on the internal organization and operation of the Board of Directors / Governing Body and the Supervisory Board.

Yes (Complies)

No (Explanation)

The Company is a private limited company that provides public information on the compositions and operations of the Board of Directors and the Supervisory Board as set out in this Corporate Governance Report.

A 4.1.10.1 The company provided information on the criteria considered when evaluating the work of the Board of Directors / Governing Body, the executive management and the individual members thereof.

Yes (Complies)

No (Explanation)

A 4.1.11 In the annual report and in the Remuneration Statement on the company's website, the company informed the public about the applied remuneration guidelines, including the remuneration and fees provided for members of the Board of Directors / Governing Body, the Supervisory Board and the executive management.

Yes (Complies)

No (Explanation)

The Company publishes the summary of its Remuneration Policy, and in the framework of the Risk Management report its remuneration data for the reporting year, in accordance with the reporting year. The Company does not publish the remuneration declaration set out in the Commission Recommendation 2004/913/EC.

A 4.1.12 The Board of Directors / Governing Body disclosed its risk management guidelines, including the system of internal controls, the applied risk management principles and basic rules, as well as information about major risks.

Yes (Complies)

No (Explanation)

The Company publishes its Risk Management report with the above content, in line with the requirements of the Credit Institution Act.

A 4.1.13 In order to provide market participants with information, the company publishes its report on corporate governance at the same time that it publishes its annual report.

Yes (Complies)

No (Explanation)

A 4.1.14 The company discloses its guidelines governing insiders' trading in the company's securities on its website.

Yes (Complies)

No (Explanation)

The Company is a private limited company whose securities are not traded publicly.

The company published in the annual report and on its website ownership in the company's securities held by the members of the Board of Directors / Governing Body, the Supervisory Board and the executive management, as well as any interests held in share-incentive schemes.

Yes (Complies)

No (Explanation)

The Company is a private limited company, whose shares are owned by three Shareholders, Erste Group Bank AG, EBRD and the Hungarian State.

A 4.1.15 In the annual report and on its website, the company disclosed any relationship between members of the Board of Directors / Governing Body and the executive management with a third party, which might have an influence on the operations of the company.

Yes (Complies)

No (Explanation)

The Company is a private limited company that treats and keeps record of the relationships between the Board of Directors and the management with third parties that can influence the operation of the Company as set out in its by-laws, in accordance with the Credit Institution Act.

Level of compliance with the Suggestions

The company should indicate whether the relevant suggestion of the CGR is applied or not (– Yes / No)

In view of the fact that the FT Recommendation contains proposals on listed public limited companies established in Hungary, the Company, as private limited company does not apply most of them. Below we list the proposals followed by the Company

J 1.1.3 The company has an investor relations department. Yes / No

J 1.2.2 The company's articles of association are available on the company's website. Yes / No

J 2.1.2 The rules of procedure define the composition of the Board of Directors / Governing Body and all procedures and protocols for the preparation and holding of meetings, the drafting of resolutions and other related matters. Yes / No

J 2.2.1 The rules of procedure and the work schedule of the Supervisory Board gives a detailed description of its operation and duties, as well as procedures and processes which the Supervisory Board followed. Yes / No

J 2.3.2 Board members had access to the proposals of a given meeting at least five days prior to the board meeting. Yes / No

J 2.3.3 The rules of procedure regulate the regular or occasional participation at board meetings of persons who are not members of the boards. Yes / No

J 2.4.3 Newly elected, non-executive board members were able to familiarize themselves with the structure and operations of the company, as well as their duties as board members through a tailored induction programme. Yes / No
Note: the Company has no induction programmes

J 2.5.2	The separation of the responsibilities of the Chairman of the Board of Directors / Governing Body from those of the Chief Executive Officer has been outlined in the basic documents of the company.	<u>Yes</u> / No
J 2.5.5	The company's Supervisory Board has no member who held a position in the Board of Directors / Governing Body or the executive management of the company in the three years prior to his nomination.	<u>Yes</u> / No
J 2.7.5	The development of the remuneration system of the Board of Directors / Governing Body, the Supervisory Board and the executive management serves the strategic interests of the company and thereby those of the shareholders.	<u>Yes</u> / No
J 2.7.6	In the case of members of the Supervisory Board, the company applies a fixed amount of remuneration and does not apply a remuneration component related to the share price.	<u>Yes</u> / No
J 2.8.2	The Board of Directors / Governing Body developed its risk management policy and regulations with the cooperation of those executives who are responsible for the design, maintenance and control of risk management procedures and their integration into the company's daily operations.	<u>Yes</u> / No
J 2.8.10	When evaluating the system of internal controls, the Board of Directors / Governing Body took into consideration the aspects mentioned in Section 2.8.10 of CGR.	<u>Yes</u> / No
J 2.8.12	The company's auditor assessed and evaluated the company's risk management systems and the risk management activity of the executive management, and submitted its report on the matter to the Audit Committee / Supervisory Board.	<u>Yes</u> / No
J 2.9.4	The Board of Directors / Governing Body may invite the company's auditor to participate in those meetings where it debates general meeting agenda items.	<u>Yes</u> / No
J 2.9.5	The company's Internal Audit function co-operated with the auditor in order to help it successfully carry out the audit.	<u>Yes</u> / No
J 3.1.4	The company's committees are made up of members who have the capabilities, professional expertise and experience required to perform their duties.	<u>Yes</u> / No
J 3.1.5	The rules of procedure of committees operating at the company include those aspects detailed in Section 3.1.5 of CGR.	<u>Yes</u> / No
J 3.2.2	The members of the Audit Committee / Supervisory Board were fully informed about the accounting, financial and operational peculiarities of the company.	<u>Yes</u> / No
J 3.3.3	The Nomination Committee prepared at least one evaluation for the chairman of the Board of Directors / Governing Body on the operation of the Board of Directors / Governing Body and the work and suitability of the members of the Board of Directors / Governing Body.	<u>Yes</u> / No

J 3.4.5	The Remuneration Committee prepared the Remuneration Statement.	<u>Yes</u> / No
J 4.1.4	The disclosure guidelines of the company at least extend to those details contained in Section 4.1.4 of CGR.	<u>Yes</u> / No
J 4.1.7	The company's financial reports followed IFRS guidelines.	<u>Yes</u> / No
J 4.1.16	The company also prepares and releases its disclosures in English.	Yes / No