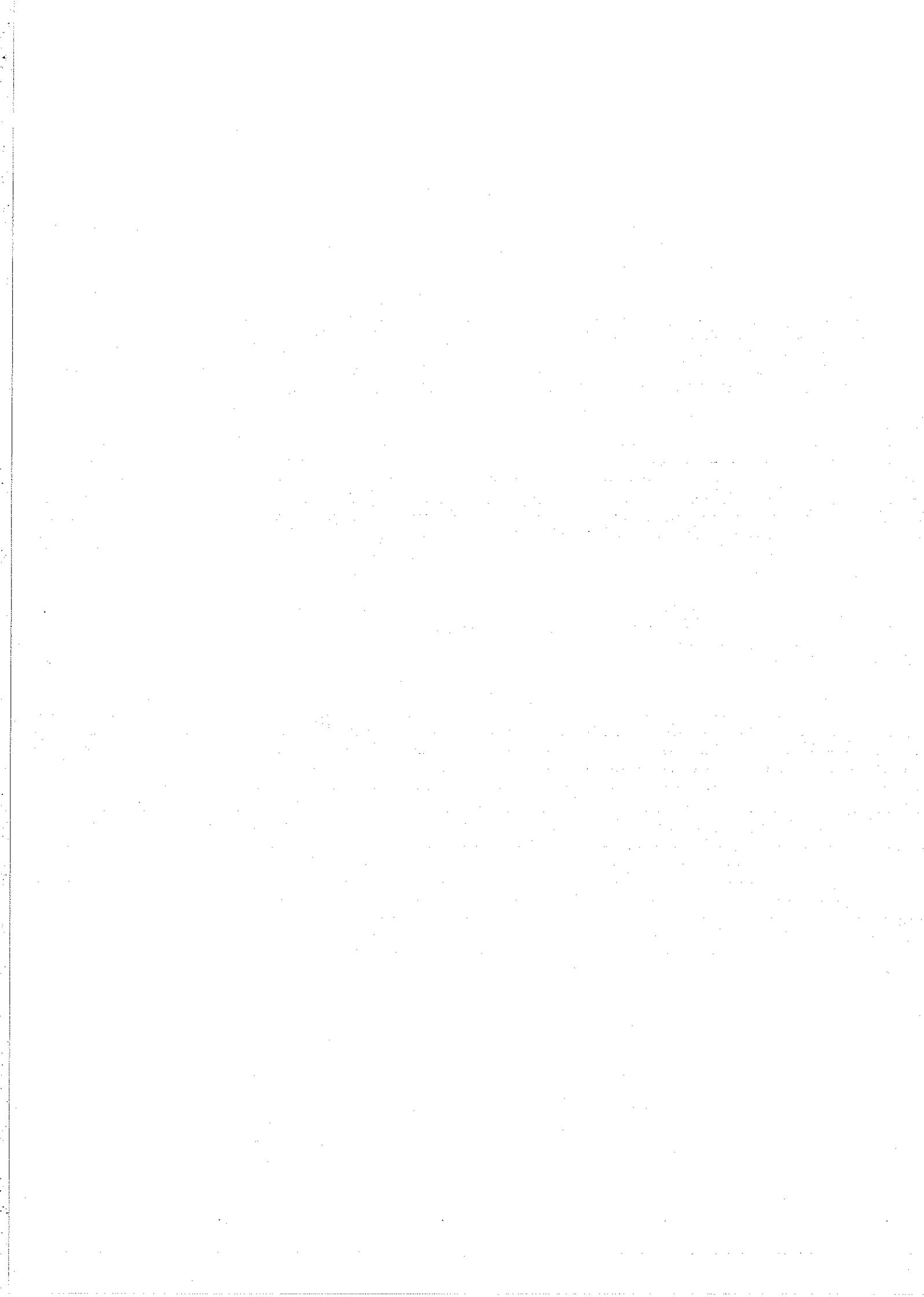


# **Erste Bank Hungary Zrt.**

CONSOLIDATED FINANCIAL STATEMENTS  
IN ACCORDANCE WITH  
INTERNATIONAL FINANCIAL REPORTING  
STANDARDS AS ADOPTED BY THE EUROPEAN UNION  
FOR THE YEAR ENDED  
31 DECEMBER 2011



# Consolidated Financial Statements

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# Consolidated Financial Statements 2011 (IFRS)

## I. Consolidated Income Statement for the year ended 31 December 2011

in HUF million	Notes	2011	2010
Interest and similar income		208,726	199,894
Interest and similar expenses		(92,626)	(86,886)
<b>Net interest income</b>	1	116,100	113,008
Fee and commission income		39,108	38,641
Fee and commission expenses		(10,053)	(10,219)
<b>Net fee and commission income</b>	2	29,055	28,422
<b>Net trading result</b>	3	11,891	15,356
Risk provisions for loans and advances	4	(225,808)	(72,854)
<b>Net operating income / (expenses)</b>		<b>(68,762)</b>	<b>83,931</b>
Personnel expenses		(26,532)	(28,999)
Other administrative expenses		(27,940)	(26,703)
Depreciation and amortisation		(5,163)	(4,890)
<b>General administrative expenses</b>	5	<b>(59,635)</b>	<b>(60,592)</b>
<b>Other operating result</b>	6	<b>(15,515)</b>	<b>(19,220)</b>
<b>Profit / (loss) before tax</b>		<b>(143,911)</b>	<b>4,119</b>
Taxes on income	7	(5,492)	(6,105)
<b>Loss for the year</b>		<b>(149,403)</b>	<b>(1,986)</b>
Attributable to:			
Non-controlling interests		0	57
<b>Owners of the parent</b>		<b>(149,403)</b>	<b>(1,929)</b>

## II. Consolidated Statement of Comprehensive Income for the year ended 31 December 2011

in HUF million	2011	2010
Loss for the year	(149,403)	(1,986)
<b>Other comprehensive income</b>		
Available for sale-reserve		
Gain during the year	1	0
Loss during the year	(23)	(24)
Deferred tax related to 'Available for sale-reserve'	4	5
<b>Other comprehensive income – total</b>	<b>(18)</b>	<b>(19)</b>
<b>Total comprehensive income</b>	<b>(149,421)</b>	<b>(2,005)</b>
Attributable to:		
Non-controlling interests	0	57
<b>Owners of the parent</b>	<b>(149,421)</b>	<b>(1,948)</b>

### III. Consolidated Statement of Financial Position at 31 December 2011

	Notes	2011	2010	As at 1 January 2010
<b>in HUF million</b>				
<b>ASSETS</b>				
Cash and balances with central banks	8	328,162	111,594	71,392
Loans and advances to credit institutions	9	226,109	119,112	30,722
Loans and advances to customers	10	2,309,752	2,258,206	2,073,907
Risk provisions for loans and advances	11	(334,158)	(143,049)	(76,765)
Derivative financial instruments	12	21,628	10,505	18,040
Trading assets	13	141,635	188,890	357,872
Financial assets - available for sale	13	160,814	31,978	1,983
Financial assets - held to maturity	13	314,002	320,120	293,106
Intangible assets	14	11,765	11,034	10,595
Property and equipment	14	11,989	12,944	12,842
Current tax assets	15	1,451	2,273	2,327
Deferred tax assets	15	58	758	2,019
Assets classified as held for sale	16	1,564	2,124	2,850
Other assets	17	53,162	27,062	17,679
<b>Total assets</b>		<b>3,247,936</b>	<b>2,953,552</b>	<b>2,818,550</b>
<b>LIABILITIES AND EQUITY</b>				
Deposits by banks	18	1,684,385	1,519,656	1,339,571
Customer deposits	19	1,201,878	1,092,732	1,137,078
Debt securities in issue	20	4,788	25,877	31,864
Derivative financial instruments	12	48,973	54,508	29,611
Trading liabilities	21	13	7,708	12,731
Provisions	22	9,405	4,873	3,787
Current tax liabilities	15	182	161	36
Deferred tax liabilities	15	366	634	2,144
Other liabilities	23	36,276	24,908	25,463
Subordinated liabilities	24	83,880	75,317	73,161
<b>Total equity</b>	25	<b>177,791</b>	<b>147,179</b>	<b>163,105</b>
Attributable to:				
Non-controlling interests		0	(32)	26
Owners of the parent		177,791	147,211	163,080
<b>Total liabilities and equity</b>		<b>3,247,936</b>	<b>2,953,552</b>	<b>2,818,550</b>

## IV. Consolidated Statement of Changes in Total Equity

### A) STATEMENT OF CHANGES IN TOTAL EQUITY FOR THE YEAR ENDED 31 DECEMBER 2011

in HUF million	Subscribed capital	Additional paid-in capital	Retained earnings	General reserve	General risk reserve	Available for sale reserve	Deferred tax	Total owners of the parent	Non-controlling interests	Total equity 2011
<b>Total equity at 01 January 2011</b>	60,910	10,449	62,200	12,230	1,422	0	0	147,211	(32)	147,179
Dividends								0		0
Capital increases	39,090	140,910						180,000		180,000
Acquisition of non-controlling interest								0	32	32
<b>Total comprehensive income</b>	0	0	(149,403)	0	0	(22)	4	(149,421)	0	(149,421)
Net profit / (loss) for the year			(149,403)					(149,403)		(149,403)
Other comprehensive income						(22)	4	(18)		(18)
Appropriation from retained earnings			13,650	(12,230)	(1,422)			0		0
<b>Total equity at 31 December 2011</b>	100,000	151,359	(73,550)	0	0	(22)	4	177,791	0	177,791

### B) STATEMENT OF CHANGES IN TOTAL EQUITY FOR THE YEAR ENDED 31 DECEMBER 2010

in HUF million	Subscribed capital	Additional paid-in capital	Retained earnings	General reserve	General risk reserve	Available for sale reserve	Deferred tax	Total owners of the parent	Non-controlling interests	Total equity 2010
<b>Total equity at 01 January 2010</b>	60,910	10,449	78,435	11,845	1,422	24	(5)	163,080	26	163,105
Dividends			(13,921)					(13,921)		(13,921)
Capital increases								0		0
Acquisition of non-controlling interest								0		0
<b>Total comprehensive income</b>	0	0	(1,929)	0	0	(24)	5	(1,948)	(57)	(2,005)
Net profit / (loss) for the year			(1,929)					(1,929)	(57)	(1,986)
Other comprehensive income						(24)	5	(19)		(19)
Appropriation from retained earnings			(385)	385				0		0
<b>Total equity at 31 December 2010</b>	60,910	10,449	62,200	12,230	1,422	0	0	147,211	(32)	147,179

## V. Consolidated Statement of Cash Flows

in HUF million	Note	2011	2010
<b>Loss for the year</b>		<b>(149,403)</b>	<b>(1,986)</b>
Non-cash adjustments for items in profit / (loss) for the year			
Depreciation and amortisation of assets	5	5,163	4,890
Impairment and reversal of impairment, revaluation of assets	6	6,898	704
Allocation to and release of provisions (including risk provisions)	VI. C., 11, 22	194,743	67,370
(Gains) / losses from the sale of assets	6	62	57
Fair value of derivative financial instruments (excluding cash option premiums)	12	(16,487)	32,009
Revaluation of subordinated liabilities	24	8,564	2,156
Change in deferred tax assets/liabilities	15	433	(250)
Other		240	135
Changes in assets and liabilities from operating activities after adjustment for non-cash components			
Loans and advances to credit institutions		(106,865)	(87,846)
Loans and advances to customers		(41,010)	(184,299)
Trading assets		46,870	168,766
Financial assets - available for sale		(287)	(132)
Financial assets - held to maturity		428	(329)
Other assets from operating activities		(26,032)	(8,601)
Deposits by banks		157,457	178,620
Customer deposits		107,901	(44,345)
Debt securities in issue		(21,089)	(5,987)
Trading liabilities		(7,717)	(4,514)
Other liabilities from operating activities		11,291	(1,045)
<b>Cash flows from operating activities</b>		<b>171,160</b>	<b>115,370</b>
Proceeds of disposal			
Financial assets - held to maturity and associated companies		27,232	88,896
Property and equipment, intangible assets and investment properties		1,489	299
Acquisition of			
Financial assets - held to maturity and associated companies		(21,542)	(115,580)
Financial assets - available for sale		(128,572)	(29,906)
Property and equipment, intangible assets and investment properties		(11,775)	(4,858)
Acquisition of subsidiaries (net of cash and cash equivalents acquired)		(1,424)	(97)
<b>Cash flows (used in) investing activities</b>		<b>(134,592)</b>	<b>(61,247)</b>
Capital increases	25	180,000	0
Dividends paid	25	0	(13,921)
<b>Cash flows from/(used in) financing activities</b>		<b>180,000</b>	<b>(13,921)</b>
<b>Cash and cash equivalents at beginning of period</b>			
		<b>111,594</b>	<b>71,392</b>
Cash flows from operating activities		171,160	115,370
Cash flows from investing activities		(134,592)	(61,247)
Cash flows from financing activities		180,000	(13,921)
<b>Cash and cash equivalents at end of period</b>	8	<b>328,162</b>	<b>111,594</b>
<b>Cash flows related to taxes, interest and dividends</b>			
Payments for taxes on income		(7,090)	(8,986)
Interest received		208,820	197,277
Dividends received		141	154
Interest paid		(100,563)	(79,680)

## 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 2011 and 2010, the direct parent of the Bank was EGB Ceps Holding GmbH, whose registered office is Graben 21, 1010 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.

#### *Change in legal form in December 2010*

Austrian EGB Ceps Holding GmbH, the majority owner of the Bank acquired the stakes of the minority owners of the Bank in 2010. The transformation of the Bank into a private limited company by shares was registered by the Court of Registry with effect from 3 January 2011. Subsequent to the decision of the Court of Registry, the full trade name of the Bank has been amended to Erste Bank Hungary Zrt. (Erste Bank Hungary Private Limited Company by shares).

#### *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, 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.

#### *Subsidiaries*

The subsidiaries of the Bank, all registered in Hungary, as of 31 December 2011 are as follow:

Company name	Interest of Erste Bank Hungary in % - directly or indirectly	Core activity
Erste Befektetési Zrt.	100%	brokerage services
Portfólió Szolgáltató Kft.	100%	data processing services
Erste Leasing Autófinanszírozási Zrt.	100%	financial leasing of vehicles
Erste Leasing Eszközfinanszírozási Zrt.	100%	financial leasing of other assets
Erste Leasing Bérlet Szolgáltató Kft.	100%	operating leasing of other assets
Erste Ingatlanlizing Zrt.	100%	financial leasing of properties
Erste Lakáslizing Zrt.	100%	financial leasing of properties
Erste Ingatlan Kft.	100%	property management
Sió Ingatlan Invest Kft.	100%	property development
Erste Faktor Zrt.	100%	factoring
Erste Pénztárszervező Kft.	100%	support company to pension fund
Erste Kereskedőház Kft.	100%	trade house
Erste Lakás-takarékpénztár Zrt.	100%	building society
Magyar Factor Zrt.	100%	factoring

### B. FIRST-TIME ADOPTION

These financial statements, for the year ended 31 December 2011, are the first Erste Hungary has prepared in accordance with International Financial Reporting Standards (IFRS). For periods up to and including the year ended 31 December 2010, Erste Hungary prepared its financial statements in accordance with Hungarian generally accepted accounting practice (local GAAP).

Accordingly, Erste Hungary has prepared financial statements which comply with IFRS applicable for periods ending on or after 31 December 2011, together with comparative period data as at and for the year ended 31 December 2010, as described in the accounting policies. In preparing these financial statements, Erste Hungary's opening statement of financial position was prepared as at 1 January 2010, Erste Hungary's date of transition to IFRS. This note explains the principal adjustments made by Erste Hungary in restating its local

GAAP statement of financial position as at 1 January 2010 and its previously published local GAAP financial statements as at and for the year ended 31 December 2010 to IFRS.

**Estimates**

Estimates at 1 January 2010 and at 31 December 2010 are consistent with those made for the same dates in accordance with local GAAP (after adjustments to reflect any differences in accounting policies).

**Exemptions applied**

IFRS 1 First-Time Adoption of International Financial Reporting Standards allows first-time adopters certain exemptions from the retrospective application of certain IFRS's. Erste Hungary has applied the following exemption:

IFRS 3 Business Combinations has not been applied to acquisitions of subsidiaries, which are considered businesses for IFRS, or of interests in associates and joint ventures that occurred before 1 January 2010. Use of this exemption means that the local GAAP carrying amounts of assets and liabilities, which are required to be recognised under IFRS, is their deemed cost at the date of the acquisition. After the date of the acquisition, measurement is in accordance with IFRS. Assets and liabilities that do not qualify for recognition under IFRS are excluded from the opening IFRS statement of financial position. Erste Hungary did not recognise or exclude any previously recognised amounts as a result of the IFRS recognition requirements.

**Reconciliation of equity as at 1 January 2010 (date of transition to IFRS)**

in HUF million	Notes	Local GAAP	Remeasurements	IFRS as at 1 January 2010
<b>ASSETS</b>				
Cash and balances with central banks	A	36,905	34,487	71,392
Loans and advances to credit institutions	A, B	65,505	(34,783)	30,722
Loans and advances to customers	B, C, D	1,983,484	90,423	2,073,907
Risk provisions for loans and advances	E	(77,966)	1,201	(76,765)
Derivative financial instruments	B	11,168	6,872	18,040
Trading assets	B, I	363,831	(5,958)	357,872
Financial assets - available for sale	C	80,222	(78,259)	1,963
Financial assets - held to maturity	B, F	279,811	13,295	293,106
Intangible assets		10,595	0	10,595
Property and equipment		12,842	0	12,842
Current tax assets		2,327	0	2,327
Deferred tax assets	G	0	2,019	2,019
Assets classified as held for sale	H	0	2,850	2,850
Other assets	B, H	76,466	(58,787)	17,679
<b>Total assets</b>		<b>2,845,190</b>	<b>(26,640)</b>	<b>2,818,550</b>
<b>LIABILITIES AND EQUITY</b>				
Deposits by banks	B	1,358,748	(19,177)	1,339,571
Customer deposits	B, F	1,135,072	2,006	1,137,078
Debt securities in issue	B	31,928	(64)	31,864
Derivative financial instruments	B	23,815	5,796	29,611
Trading liabilities	I	0	12,731	12,731
Provisions	J	5,017	(1,230)	3,787
Current tax liabilities		0	36	36
Deferred tax liabilities	G	0	2,144	2,144
Other liabilities	B	76,033	(50,570)	25,463
Subordinated liabilities		73,793	(632)	73,161
<b>Total equity</b>	D, E, F, J, K	<b>140,784</b>	<b>22,321</b>	<b>163,105</b>
Attributable to:				
Non-controlling interests		3	23	26
Owners of the parent		0	163,080	163,080
<b>Total liabilities and equity</b>		<b>2,845,190</b>	<b>(26,640)</b>	<b>2,818,550</b>

### Group reconciliation of equity as at 31 December 2010

in HUF million	Notes	Local GAAP	Remeasurements	IFRS as at 31 December 2010
<b>ASSETS</b>				
Cash and balances with central banks	A	34,861	76,733	111,594
Loans and advances to credit institutions	A, B	195,055	(75,943)	119,112
Loans and advances to customers	B, C, D	2,148,575	109,631	2,258,206
Risk provisions for loans and advances	E	(130,885)	(12,164)	(143,049)
Derivative financial instruments	B	8,200	2,305	10,505
Trading assets	B, I	190,687	(1,796)	188,890
Financial assets - available for sale	C	128,398	(96,421)	31,978
Financial assets - held to maturity	B, F	310,374	9,746	320,120
Intangible assets		11,034	0	11,034
Property and equipment		12,944	0	12,944
Current tax assets		2,273	0	2,273
Deferred tax assets	G	0	758	758
Assets classified as held for sale	H	0	2,124	2,124
Other assets	B, H	74,743	(47,681)	27,062
<b>Total assets</b>		<b>2,986,259</b>	<b>(32,707)</b>	<b>2,953,552</b>
<b>LIABILITIES AND EQUITY</b>				
Deposits by banks	B	1,517,409	2,247	1,519,656
Customer deposits	B, F	1,114,594	(21,862)	1,092,732
Debt securities in issue	B	24,152	1,725	25,877
Derivative financial instruments	B	54,224	284	54,508
Trading liabilities	I	0	7,708	7,708
Provisions	J	7,317	(2,444)	4,873
Current tax liabilities		0	161	161
Deferred tax liabilities	G	0	634	634
Other liabilities	B	46,258	(21,350)	24,908
Subordinated liabilities		75,864	(547)	75,317
Total equity	D, E, F, J	146,441	738	147,179
Attributable to:				
Non-controlling interests		107	(139)	(32)
Owners of the parent		0	147,211	147,211
<b>Total liabilities and equity</b>		<b>2,986,259</b>	<b>(32,707)</b>	<b>2,953,552</b>

**Reconciliation of income for the year ended 31 December 2010**

in HUF million	Notes	Local GAAP	Remeasurements	IFRS as at 31 December 2010
Interest and similar income	D	201,276	(1,383)	199,894
Interest and similar expenses		(87,072)	186	(86,886)
<b>Net interest income</b>		<b>114,204</b>	<b>(1,196)</b>	<b>113,008</b>
Fee and commission income	D	40,641	(1,999)	38,641
Fee and commission expenses	D	(13,681)	3,461	(10,219)
<b>Net fee and commission income</b>		<b>26,960</b>	<b>1,462</b>	<b>28,422</b>
Net trading result		9,487	5,869	15,356
Risk provisions for loans and advances	E	(57,327)	(15,526)	(72,854)
<b>Net operating income</b>		<b>93,324</b>	<b>(9,392)</b>	<b>83,931</b>
General administrative expenses		(60,591)	0	(60,592)
Other operating result		(20,831)	1,611	(19,220)
<b>Profit (loss) before tax</b>		<b>11,901</b>	<b>(7,782)</b>	<b>4,119</b>
Taxes on income		(6,248)	143	(6,105)
<b>Profit (loss) for the year</b>		<b>5,653</b>	<b>(7,639)</b>	<b>(1,986)</b>
General reserve on loss for the year by local regulation (Note 25)	M	(385)	385	0
Attributable to:				
Non-controlling interests		(88)	145	57
<b>Owners of the parent</b>		<b>5,180</b>	<b>(7,494)</b>	<b>(1,929)</b>

**Reconciliation of other comprehensive income for the year ended 31 December 2010**

in HUF million	Notes	Local GAAP	Remeasurements	IFRS as at 31 December 2010
<b>Loss for the year</b>		<b>5,653</b>	<b>(7,639)</b>	<b>(1,986)</b>
Other comprehensive income				
Available for sale-reserve	F, L	58	(58)	0
Deferred tax related to 'Available for sale-reserve'	G	0	5	5
<b>Other comprehensive income - total</b>		<b>58</b>	<b>(78)</b>	<b>(19)</b>
<b>Total comprehensive income</b>		<b>5,711</b>	<b>(7,717)</b>	<b>(2,005)</b>
Attributable to:				
Non-controlling interests		(88)	145	57
<b>Owners of the parent</b>		<b>5,623</b>	<b>(7,571)</b>	<b>(1,948)</b>

**Reconciliation of cash and cash equivalents**

in HUF million	Notes	As at 31 December 2011	As at 31 December 2010	As at 1 January 2010
Cash in hand		17,273	18,182	16,892
Nostro account with Hungarian National Bank		34,506	16,679	20,014
<b>Cash and cash equivalents by local GAAP</b>		<b>51,779</b>	<b>34,861</b>	<b>36,905</b>
In addition in IFRS accounts:				
Interbank account with Hungarian National Bank	A	276,383	76,733	34,487
<b>Cash and cash equivalents by IFRS</b>		<b>328,162</b>	<b>111,594</b>	<b>71,392</b>

Categories included in the cash flow statement under local GAAP are not comparable to the categories requested by IFRS, and for that reason the full reconciliation is not practical.

## Notes to the reconciliation of equity as at 1 January 2010 and 31 December 2010 and income and other comprehensive income for the year ended 31 December 2010

In order to minimise presentation differences shown as remeasurement, the local GAAP financial statements are presented after reasonable reclassifications between line items for presentation differences.

### Note A

Interbank accounts with the Hungarian National Bank (contains mainly money market deals) are shown within 'Cash and balances with central banks' in the IFRS financial statements, while classified as 'Loans and advances to credit institutions' under local GAAP.

### Note B

Accrued interest is presented with the underlying instrument under IFRS, while in 'Other asset' or 'Other liability' under local GAAP.

### Note C

Municipality bonds are presented as 'Loans and advances to customers' under IFRS, while classified under 'Financial assets – available for sale' under local GAAP.

### Note D

There are two major differences between local GAAP and IFRS:

- 1, Suspended interest - interest is suspended when the due amount is not received till balance sheet preparation date under local GAAP rules while interest is recognised under IFRS on all loans even on non performing loans for the first 90 days that amounts are overdue.
- 2, Amortisation of upfront fees - upfront fees are amortised using the effective interest rate over the maturity of the underlying instrument and shown in exposure under IFRS. For local GAAP upfront fees are recognised immediately in the income statement.

### Note E

There are three major differences between local GAAP and IFRS in relation to the valuation of risk provisions:

- 1, Local GAAP does not allow a portfolio provision, except for the retail portfolio.
- 2, Risk exposure is different: under IFRS, the risk provision is calculated on the amortised cost basis, while under local GAAP the risk provision is based on outstanding capital.
- 3, The difference in discounted cash flows of an impaired loan between two valuation dates is unwinding and is recognised in net interest income under IFRS.

The remeasurement also contains a correction of an error of 4,904 million forint that increased the risk provisions and decreased opening retained earnings as at 1 January 2010. The correction of error included an 8,636 million forint increase in risk provisions and a 3,732 million forint decrease in the annual result as at 31 December 2010 compared to local GAAP.

### Note F

Delivery repo transactions are recognised as sales transactions under local GAAP. Under IFRS the asset in a repo deal is recognised in the books of the transferor.

### Note G

Local GAAP does not allow recognition of deferred taxes.

### Note H

The 'Assets classified as held for sale' category is not used under local GAAP, so assets recorded in this category are shown in 'Other assets' under local GAAP.

### Note I

In accordance with IFRS, securities borrowed are not recognised on the statement of financial position, unless they are then sold to third parties, in which case the obligation to return the securities is recognised as a trading liability, while local GAAP recognises securities borrowing as a security sale/purchase against a technical liability/asset.

### Note J

Allocation of the general risk reserve is based on Hungarian regulations, and recognised as a 'Provision' under local GAAP, while classified as equity for IFRS, as an appropriation from retained earnings.

Note K

At 1 January 2010 dividends payable of 13 billion forint are recognised in equity under local GAAP, and shown in the following year under IFRS.

Note L

The premium/discount related to securities recognised in the 'Available for sale' portfolio is included in fair value for local GAAP, while amortised over the maturity and shown together with the underlying instrument by IFRS.

Note M

The General reserve is allocated based on Hungarian regulations (see in Note 25) for the profit for the year under local GAAP. For IFRS, the reserve is an appropriation from retained earnings in the coming year.

## C. ACQUISITIONS AND DISPOSALS

*(i) Acquisition of 100% shares of Sió Ingatlan Invest Kft. – April 2010*

Erste Hungary acquired Sió Ingatlan Invest Kft. for 97 million forint in 2010. The fair value of the assets acquired and the liabilities assumed in million forint was as follows:

Fair value recognised on acquisition	
Cash in hand	0
Loans and advances to credit institutions	545
Intangible assets	5
Property and equipment	1 627
Deposits by banks	(1 465)
Other liabilities	(615)
<b>Net asset acquired</b>	<b>97</b>
<b>Total purchase price paid</b>	<b>97</b>
Goodwill	0
<b>Acquisition of subsidiary net of cash</b>	<b>97</b>

The net assets recognised at acquisition were based on the net book value of the unfinished project acquired. The acquired company generated no revenue and 0.1 million forint profit since the acquisition date. The annual loss of the company was 17.8 million forint (no revenue generated).

*(ii) Acquisition of 100% shares of Magyar Factor Zrt. from BRE Bank and Intermarket Bank AG – 9 September 2011*

The Bank acquired Magyar Factor Zrt. in two steps during 2011. The first 50% was acquired from BRE Bank and the remaining share was acquired from Intermarket Bank AG. The total purchase price paid for the assets and liabilities of Magyar Factor at acquisition was 1,381 million forint. The fair value of the assets acquired and the liabilities assumed in million forint was as follows:

Fair value recognised on acquisition	
Cash in hand	1
Loans and advances to credit institutions	131
Loans and advances to customers	9 562
Intangible assets	185
Property and equipment	40
Other assets	77
Deposits by banks	(7 272)
Customer deposits	(1 244)
Current tax liabilities	(72)
Other liabilities	(27)
<b>Net asset acquired</b>	<b>1 381</b>
<b>Total purchase price paid</b>	<b>1 381</b>
Goodwill	0
<b>Acquisition of subsidiary net of cash</b>	<b>1 380</b>

At acquisition date the gross contractual cash flows of loans to customers and the amounts not expected to be collected were as follows:

Loans and advances to customers	10 460
Risk provisions for loans and advances	(898)
	9 562

The net assets recognised at the acquisition date were based on an internal expert review which resulted in a 539 million forint decrease in the net carrying amount of the loan portfolio and a 97 million forint decrease in the carrying amount of intangible assets. The acquired company generated 182.5 million forint of revenue and 30 million forint profit since the acquisition date. The annual revenue of the company was 690 million forint and the annual profit was 36.4 million forint.

*(iii) Establishment of Erste Building Society Ltd. – October 2011*

Due to the high market potential and the high equity return potential of shareholders, the Bank's Management Board decided to establish Erste Building Society Ltd. as a new subsidiary. The new subsidiary's subscribed capital is 2 billion forint and commenced sales activity in October 2011.

*(iv) Erste Hungary's corporate structuring project*

In order to simplify the group's legal structure, Erste Hungary launched a project which resulted in the following changes being made:

- 25 August 2011: the Bank purchased 1% ownership of Erste Faktor Zrt. from Portfolió Kft., becoming 100% direct owner of the company
- 6 December 2011: voluntary winding-up of Erste-Dat Kft.
- 15 December 2011: the Bank purchased 1,96% ownership of Erste Leasing Autófinanszírozási Zrt. from Erste Bank der Österreichischen Sparkassen AG, becoming 100% owner of the company.

The purchase of the non-controlling interest affects the consolidated financial statements, while the other transactions were among common controlled entities.

## D. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS

In June 2011 the Hungarian Parliament approved a new law called the "Home rescue plan" applicable to financial institutions. The plan was subsequently amended in September 2011 and was completed with additional modifications in March 2012. 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. During 2011 Erste Hungary recognised significant losses due to the new government legislation. The different constructions detailed in the act were as follows:

*A, Endpayment (passed September 2011)*

Under the law eligible customers were allowed to repay in one lump sum their mortgage loans denominated in defined foreign currencies (endpayment) at fixed foreign exchange rates of:

CHF at 180 HUF  
 EUR at 250 HUF  
 JPY at 2 HUF

Those customers who fulfilled certain requirements could make their endpayment between the end of September 2011 and 29 February 2012. Customers were required to announce their intention of endpayment by 30 December 2011 and were also required to provide evidence by 30 January 2012 that the necessary funds for the endpayment were available. More than 24 thousand customers of the Bank repaid their mortgage loans under the arrangements.

Erste Hungary's total loss amounted to 57.5 billion forint, recognised in Risk provisions in the Consolidated Income Statement. The realised loss of Erste Hungary to 31 December 2011 was 29 billion forint and an additional 28.5 billion forint loss was estimated based on the open applications at 31 December 2011.

The Banking tax act was also amended in December 2011, allowing 30% of the losses arising from the above endpayment to be reclaimed from 2011 banking tax. As 30% of the recognized losses exceeded the group's 2011 banking tax obligation Erste Hungary presents nil banking tax in the consolidated income statement and the entire banking tax amount paid is presented as tax receivable in the consolidated statement of financial position in 2011.

*B. Measures related to customers of more than 90 days past due (passed March 2012)*

Based on the 15 December 2011 Agreement between the Hungarian Government and the Hungarian Banking Association the following modification of the law was passed on 22 March 2012, reflecting the same wording and essence as published in the December Agreement.

Clients with more than 90 days past due instalments as at 30 September 2011 and whose collateral values do not exceed 20 million forint at disbursement and whose the loan agreement has not been terminated are eligible under this act. For clients electing to participate in this scheme, Erste Hungary is obliged to write off 25% of the total outstanding exposure and convert the foreign exchange loan into a forint denominated loan. Erste Hungary estimated and recognised an additional loss of 5.4 billion forint included in Risk provisions at 31 December 2011 for this part of its mortgage portfolio.

30% of the losses generated from this legislation can be reclaimed from 2012 banking tax.

*C. Measures related to customers of less than 90 days past due or current (passed March 2012)*

As part of the same agreement and same modification of the legal act mentioned under point B, eligible customers may apply to fix their monthly instalments at a lower preferential foreign exchange rate for the next five years (fixed rates see point A). Differences between the current and fixed preferential foreign exchange rates relating to the capital element of the monthly instalments will be accumulated in a buffer account bearing a BUBOR-only interest, while differences relating to the interest element of the monthly instalments will be shared between the financial institutions and the Hungarian Government on a 50-50% basis. Should foreign exchange rates exceed levels of 270 CHF/HUF and 340 EUR/HUF all excess amounts will be borne by the Hungarian Government. The government's share will be settled on a quarterly basis.

Based on management's estimate and assuming a customer participation rate of 100% in this scheme, the total impact on the consolidated income statement for the five year period is estimated to be a loss of 17.8 billion forint relating to the interest element and 4.3 billion forint relating to the capital element for the buffer account that will bear below market rate interest.

## **E. ACCOUNTING POLICIES**

### **a) BASIS OF PREPARATION**

The consolidated financial statements of Erste Hungary for the 2011 financial year and the comparable data for 2010 and 1 January 2010 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 and liabilities held for trading, all of which have been measured at fair value.

The consolidated financial statements for the year ended 31 December 2011 were authorised for issue in accordance with a resolution of the directors on 24 April 2012.

### **Basis of consolidation**

All subsidiaries directly 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 the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. 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, by using consistent accounting policies. All intra-group balances, transactions, income and expenses as well as unrealised gains and loss and dividends are eliminated. Non-controlling interests represent the portion of total comprehensive income and net assets, which are not attributable to owners.

## b) ACCOUNTING AND MEASUREMENT METHODS

### 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 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.

### 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 following measurement categories:

- financial assets or financial liabilities at fair value through profit or loss, including:
  - trading instruments
  - derivative instruments
- available for sale financial assets
- held to maturity investments
- loans and receivables

Relationships between the statement of financial position line items and measurement categories are described in the below table:

Statement of financial position	Measurement method		
	Fair Value	At amortised cost	Other
<b>ASSETS</b>			Nominal value
Cash and balances with central banks			
Loans and advances to credit institutions		x	
Loans and advances to customers		x	
Risk provisions for loans and advances		x	
Derivative financial instruments	x		
Trading assets	x		
Financial assets - available for sale	x		
Financial assets - held to maturity		x	
<b>LIABILITIES</b>			
Deposits by banks		x	
Customer deposits		x	
Debt securities in issue		x	
Derivative financial instruments	x		
Trading liabilities	x		
Subordinated liabilities			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.

*(iii) Cash and cash equivalents*

Cash and cash equivalents as referred to in the statement of cash flows comprises cash on hand and current accounts with central banks. Mandatory minimum reserve is shown here:

the Bank is obliged to keep a minimum 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. The obligation is fulfilled if the monthly average of this separate account reaches the calculated amount.

Cash and cash equivalents are shown under 'Cash and balances with central banks' in the statement of financial position.

*(iv) Derivatives*

Derivatives used by Erste Hungary include mainly 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. All derivatives disregarding their internal classification are disclosed under the line item 'Derivative financial instruments' which can be found both on the assets and liabilities side of the statement of financial position.

*(v) Financial assets and 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. 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 'Trading assets' or 'Trading liabilities' in the statement of financial position.

*(vi) Available for sale financial assets*

Available for sale assets 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, available for sale financial assets 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 available-for-sale assets 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 the line item 'Result from financial assets - available for sale'. In the statement of financial position, available for sale financial assets are disclosed in the line item '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 and dividend income on available for sale financial assets is reported in the income statement as 'Interest and similar income'.

*(vii) Held to maturity financial investments*

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 'Interest and similar income'. Losses arising

from impairment of such investments as well as realised gains or losses from selling are recognised in the income statement in the line 'Result from financial assets – held to maturity'.

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 advances*

The statement of financial position line items 'Loans and advances to credit institutions' and 'Loans and advances to customers' meet the definition of loans and receivables category. Loans and advances include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

After initial measurement, loans and advances are subsequently measured at amortised cost including impairment. Interest income earned is included in 'Interest and similar income' in the income statement. Allowance for impairment is reported in the statement of financial position line 'Risk provisions for loans and advances'. Losses arising from impairment are recognised in the income statement line 'Risk provisions for loans and advances'.

Securities issued by municipalities are classified into 'Loans and advances to customers', recorded at amortised cost, as there is no market for them. Their impairment is reported under 'Risk provisions for loans and advances'.

*(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. Besides 'Trading liabilities' and 'Derivative financial instruments' liabilities are reported in the lines 'Deposits by banks', 'Customer deposits' 'Debt securities in issue' or 'Subordinated liabilities'. Interest expenses incurred are reported in the line 'Interest and similar expenses' in the income statement.

**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 by banks' or 'Customer deposits' 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 'Interest and similar expenses' and is accrued over the life of agreement. 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 advances to credit institutions' or 'Loans and advances 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 in line 'Interest and similar income' and is accrued over the life of the agreement.

### **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 amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

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.

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.

### **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 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 advances, any impairment is reported in the allowance account referred to as 'Risk provisions for loans and advances' in the statement of financial position and the amount of the loss is recognised in the income statement line 'Risk provisions for loans and advances'. Risk provisions for loans and advances include specific risk provisions for loans and advances for which objective evidence of impairment exists. In addition, risk provisions for loans and advances 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 asset account and in the income statement line 'Result from financial assets – held to maturity'. 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 'Interest and similar 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 advances. 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) Available for sale financial investments*

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. Impairment is recognised if the fair value decreases significantly and it stays permanently at that decreased level. If, in a subsequent period, the fair value of a debt instrument increases and the increase can be objectively related to 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 the line 'Result from financial assets – available for sale' Impairment losses and their reversals are recognised directly against the assets in the statement of financial position.

**Impairment of non-financial assets**

The Bank 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**

Although Erste Hungary makes use of derivative instruments to manage exposures to interest rate risk and foreign currency risk, the Bank does not apply hedge accounting.

### 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.

#### *Erste Hungary as a lessor*

The lessor in the case of a finance lease reports a receivable against the lessee amounting to present value of the contractually agreed payments taking into account any residual value. 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 – own land and 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:

	<b>Useful life in years</b>
Own land and buildings	16.67 or 50
Office and plant equipment / other fixed assets	1 - 7
IT assets (hardware)	2 - 10

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 purchase 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.

### Repossessed assets

Erste Hungary generally takes possession of assets related to leasing contracts, loan contracts of property developments or properties previously served as collateral is taken over.

Repossessed cars are classified in the 'Assets classified as held for sale' category.

Repossessed properties are classified under 'Other assets' as inventories, shown at 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.

#### **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 line 'Assets classified as held for sale'. 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 classified as held for sale'.

Plant and equipment once classified as held for sale are not depreciated.

#### **Intangible assets**

Erste Hungary's other intangible assets mainly include 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 financial guarantee contract is reviewed for possible requirement for provisions under IAS 37.

The premium received is recognised in the statement of comprehensive income in 'Net fee and commission income' on a straight line basis over the life of the guarantee.

#### **Defined employee benefit plans**

The defined employee benefit plan is operated by Erste Hungary, for jubilee benefits to which Hungarian 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 'Other provisions'. They include credit risk provisions for off-balance-sheet transactions (particularly warranties and guarantees) 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 income statement in the line 'Risk provisions for loans and advances', all other expenses or income from releases related to provisions are reported in the line 'Other operating result'.

Provisions for off-balance position transactions (particularly warranties and guarantees as well as other credit commitments) are included in the statement of financial position line 'Provisions', the related expense is reported in the income statement in line 'Risk provisions for loans and advances'.

### **Share-based payment transactions**

Erste Hungary does not have its own share based payment plans, but Erste Group offers 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.

Under the ESOP, Erste Group shares are offered to employees at a defined discount price. Expense incurred from the market price and the discount price is immediately recognised in personnel expenses under the line 'Personnel expenses'. Under the MSOP, Erste Group share options were granted to Erste Hungary managers and other key personnel in years 2005-2008.

### **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 and 2012. 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. For 2010, 2011 and 2012 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 activi-

ties shown in the annual report by local GAAP for the year 2009 and the tax rate is 5.6 %. In case of leasing and factor 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% up to 2012.

As 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. According to the passed law the banking tax will remain in effect till the end of 2014.

Losses generated by the endpayment law could be compensated through 2011 banking tax, up to 30% of the recognised loss. Therefore Erste Hungary shows zero banking tax in income statement of 2011. Details of endpayment and other legal relevancies see in Note VI. D. (page 14-15).

Banking tax for Erste Hungary is expected to be 14,439 million forint in 2012, the liability which is established on January 1 2012 and from which 6,640 million forint is expected to be reclaimed (see Note VI. D. page 14-15).

### **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*

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 no future credit losses. Interest income from individually 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.

Interest and similar 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. Interest and similar expenses mainly include interest paid on deposits by banks and customer deposits, debt securities in issue.

Also reported in interest and similar income is 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 result*

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

#### *(iv) Risk provisions for loans and advances*

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.

*(vi) Other operating result*

Other operating result 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, expenses of debt collection. In addition, other operating result encompasses the following: expenses for other taxes including special bank taxes, deposit insurance contributions; income from the release of and expenses for allocations to other provisions.

**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 the Note 33) Fair value of 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 in the note 31) Risk Management in the part Credit risk – Non-performing assets and risk provisions. Development of loan loss provisions is described in the note 11) Risk provisions for loans and advances.

*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. This is especially relevant for cash generating units which contain goodwill which have to be tested for impairment annually. 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. Assumptions and estimates used for impairment on non-financial assets calculations are described in the part Business combination and goodwill of the accounting policies.

*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 in the note 15) 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.

#### **Segment reporting**

The bank's segmental reporting is based on the following operating segments:

Retail, Local corporate, Real Estate, Assets and Liabilities management, Group Large Corporate, Group Markets, Corporate Centre and Free capital.

Erste Hungary does not report its geographical markets because it mostly 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.

#### **c) APPLICATION OF AMENDED AND NEW IFRS/IAS**

Standards issued but not yet effective up to the date of Erste Hungary's financial statements are listed below. The listing is of Standards and interpretations issued which Erste Hungary reasonably expects to be applicable at a future date. Erste Hungary intends to adopt those standards when they become effective.

#### **Standards and interpretations not yet effective**

##### *Amendments to IFRS 7 - Disclosures—Transfers of Financial Assets*

Amendment of IFRS 7 was issued in October 2010 and is effective for financial years beginning on or after 1 July 2011. The aim of the new disclosures is that users are able to understand relationships between transferred financial assets (which are not derecognised) and associated liabilities resulting from such transfers. The disclosure requirements also enable users to evaluate the nature and risks retained in those transferred financial assets which are derecognised but where the entity keeps some continuing involvement in the transferred assets.

The amendment is not expected to have material effect on the financial statements of Erste Hungary but will result in new disclosures. Erste Hungary decided not to apply the amendment before it becomes effective.

##### *IFRS 9: Financial Instruments - Classification and measurement*

The new IFRS 9 standard was issued in November 2009 and becomes effective for financial years beginning on or after 1 January 2013. Earlier application is permitted. However, as the EU has not yet endorsed the standard, it is therefore not yet applicable for EU entities for the 2011 financial year. An amendment concerning accounting for financial liabilities issued in October 2010 supplemented the existing requirements for classification and measurement of financial assets, which were issued in November 2009.

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 conditions are met: a) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows and b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets are measured at fair value with changes recognised in Income Statement, except of equity instruments that could be valued through other comprehensive income. Based on changes in the business model an entity shall reclassify all affected assets from fair value to amortised cost category or vice versa.

#### **Issued standards not yet endorsed by European Union**

##### *IFRS 10 Consolidated Financial Statements*

IFRS 10 was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. It replaces IAS 27, "Consolidated and Separate Financial Statements" and interpretation SIC-12, "Consolidation – Special Purpose Entities".

IFRS 10 establishes a single control model that applies to all entities, including those that were previously considered special purpose entities under SIC-12. An investor controls an investee when it is exposed, or has rights to variable returns from the investee, and has the ability to affect those returns through its power over the investee. The assessment of control is based on all facts and circumstances and the conclusion is reassessed if there is an indication that there are changes in facts and circumstances.

Furthermore, IFRS 10 addresses other issues such as control with less than majority of voting rights, control solely through rights other than voting rights, delegated decision rights. Parts dealing with consolidation procedures, non-controlling interests and loss of control were taken over into IFRS 10 from IAS 27.

Erste Hungary is currently evaluating the control of its subsidiaries in light of the new definition of control in IFRS 10. Erste Hungary decided not to apply IFRS 10 before it becomes effective, but at this time it is not practical to quantify the impacts of it.

#### *IFRS 11 Joint Arrangements*

IFRS 11 was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. It supersedes IAS 31, "Interests in Joint Ventures" and SIC-13, "Jointly-controlled Entities – Nonmonetary Contributions by Venturers".

IFRS 11 focuses on the nature of the rights and obligations of the arrangement. It classifies joint arrangements as either joint ventures or joint operations. IFRS 11 requires the use of the equity method of accounting for joint ventures by eliminating the option to use the proportionate consolidation method. The standard is not relevant for Erste Hungary.

As Erste Hungary has no jointly controlled investments and does not apply proportionate consolidation method allowed in IAS 31, the application of this standard is not expected to have any impact on Erste Hungary's financial statements.

#### *IFRS 12 Disclosure of Involvement in Other Entities*

IFRS 12 was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. It establishes the provision of information on the nature, associated risks, and financial effects of interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities, as disclosure objectives. IFRS 12 requires comprehensive disclosure, and specifies minimum disclosures that an entity must provide to meet the disclosure objectives. Disclosures are provided separately for subsidiaries, joint operations, joint ventures, associates, unconsolidated structured entities. IFRS 12 is a comprehensive standard for disclosures. Therefore no specific disclosure requirements can be found in IFRS 10, IFRS 11 and IAS 28.

Application of this standard, which Erste Hungary is currently assessing, is not expected to have any significant impact on Erste Hungary's financial statements. However, it will result in new disclosures. Erste Hungary decided not to apply IFRS 12 before it becomes effective

#### *IAS 27 (revised 2011) Separate Financial Statements*

Revised IAS 27 was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. After revision only the part relevant for individual financial statements was kept in IAS 27. This is due to the fact that IFRS 10 becomes a new standard relevant for consolidated financial statements. This resulted in a change of the name of the IAS 27. IAS 27 revised is not expected to have material effect on financial statements of Erste Hungary. Erste Hungary decided not to apply IAS 27 issued in 2011 before it becomes effective.

#### *IAS 28 (revised 2011) Investments in Associates and Joint Ventures*

Revised IAS 28 was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. Joint ventures are added in the scope of the revised IAS 28 which also results in the change of the name of the standard. This is due to the fact that under IFRS 11 equity method is the only way of including the joint ventures in the consolidated financial statements. IAS 28 revised is not expected to have a material effect on financial statements of Erste Hungary. Erste Hungary decided not to apply IAS 28 issued in 2011 before it becomes effective.

#### *IFRS 13 Fair Value Measurement*

IFRS 13 was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. It establishes a single source of guidance for fair value measurement under IFRS. It applies for fair value measurements which are already required or permitted by other standards. Therefore IFRS 13 does not increase the scope of assets and liabilities measured at fair value. IFRS 13 also introduces more comprehensive disclosure requirements on fair value measurement (e.g. fair value hierarchy enhanced also to financial instruments measured at amortised cost).

Application of these amendments does not have any impact on Erste Hungary's financial statements as Erste Hungary had decided not to apply the fair value measurement standard prior to its effective date. It is not practical to quantify the estimated effects of this new standard.

*Amendments to IFRS 1: Severe Hyperinflation and Removal of Fixed Dates for First-Time Adopters*

Amendments to IFRS 1 were issued in December 2010 and are effective for annual periods beginning on or after 1 July 2011.

*Amendments to IAS 12 - Deferred Tax: Recovery of Underlying Assets*

Amendments to IAS 12 were issued in December 2010 and are effective for annual periods beginning on or after 1 January 2012. These amendments provide clarification for deferred taxes arising from investment property measured using the fair value model in IAS 40. For such property there is a rebuttable presumption that the carrying amount of the property will be recovered entirely through sale rather than through use. Application of these amendments is not expected to have any impact on Erste Hungary's financial statements since Erste Hungary does not use investment property category.

*Amendments to IAS 1 - Presentation of Items of Other Comprehensive Income*

Amendments to IAS 1 were issued in June 2011 and become effective for annual periods beginning on or after 1 July 2012. The main requirement is to present the items of other comprehensive income (OCI) depending on whether they are reclassifiable to profit or loss or not. Moreover, if OCI items are presented before tax then the tax related to each of the two categories has to be presented separately.

Application of these amendments will have an impact on the presentation of the statement of comprehensive income due to changes in the presentation of OCI items and their tax effects. Erste Hungary decided not to apply these amendments before they become effective.

*IFRIC14 (IAS 19 revised 2011) Employee Benefits*

IAS 19 revised was issued in June 2011 and becomes effective for annual periods beginning on or after 1 January 2013. The revision brought changes mainly for accounting for defined benefit plans. Net interest is recognised in profit or loss by multiplying the net defined liability by the discount rate. Actuarial gains and losses are treated as re-measurements and are recognised fully in other comprehensive income. Clarifications were done for the area of plan amendments, curtailments and settlements. Past service costs are recognised immediately in profit or loss. Disclosure requirements were revised. New definition and recognition criteria were introduced for the termination benefits.

Application of this standard is not expected to have any impact on Erste Hungary's financial statements. Erste Hungary decided not to apply IAS 19 issued in 2011 before it becomes effective.

## F. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1) Net interest income

in HUF million	2011	2010
<b>Interest income</b>		
Lending and money market transactions with credit institutions	12,038	6,748
Lending and money market transactions with customers	145,265	145,906
Bonds and other interest-bearing securities – AFS	6,681	5,320
Bonds and other interest-bearing securities – HtM	23,586	24,340
Income from investments <sup>1)</sup>	140	155
	<b>187,710</b>	<b>182,466</b>
Bonds and other interest-bearing securities – trading	21,016	17,427
<b>Interest income on financial assets designated at fair value through profit or loss</b>	<b>21,016</b>	<b>17,427</b>
<b>Total interest and similar income</b>	<b>208,726</b>	<b>199,894</b>
<b>Interest expenses</b>		
Deposits by banks	(39,247)	(31,320)
Customer deposits	(50,127)	(51,246)
Debt securities in issue	(730)	(2,250)
Subordinated liabilities	(2,522)	(2,070)
	<b>(92,626)</b>	<b>(86,886)</b>
<b>Interest expense on financial assets designated at fair value through profit or loss</b>	<b>0</b>	<b>0</b>
<b>Total interest and similar expenses</b>	<b>(92,626)</b>	<b>(86,886)</b>
<b>Total</b>	<b>116,100</b>	<b>113,008</b>

1) dividend received from other investments

The interest income related to the non-performing portfolio is 7,193 million forint in 2011 and 2,629 million forint in 2010.

### 2) Net fee and commission income

in HUF million	2011	2010
<b>Lending business</b>	<b>551</b>	<b>876</b>
Payment transfers	18,920	18,974
of which card business	7,021	7,198
<b>Securities business</b>	<b>6,025</b>	<b>6,013</b>
Investment fund transactions	2,132	2,187
Custodial fees	627	506
Brokerage	3,266	3,320
Insurance brokerage	1,856	1,167
Building society brokerage	181	141
Investment banking business	1,293	988
Other fee and commission income	229	263
<b>Total</b>	<b>29,055</b>	<b>28,422</b>

### 3) Net trading result

in HUF million	2011	2010
Securities	3,934	538
Derivatives	13,495	1,058
Foreign exchange transactions (trading)	(5,538)	13,760
<b>Total</b>	<b>11,891</b>	<b>15,356</b>

Interest on trading securities is in 'Net interest income'.

### 4) Risk provisions for loans and advances

in HUF million	2011	2010
Allocation to risk provisions for loans and advances	(221,323)	(83,679)
Release of risk provisions for loans and advances	29,400	14,445
Direct write-offs of loans and advances	(34,439)	(4,079)
Recoveries on written-off loans and advances	1	8
<b>Risk provision related to loans and advances</b>	<b>(226,361)</b>	<b>(73,305)</b>
Allocation of provision for guarantees	(330)	(1,439)
Allocation of provision as a precaution	(16)	(2)
Release of provision for guarantees	897	1,802
Release of provision as a precaution	2	90
<b>Sundry provision related to loans and advances</b>	<b>553</b>	<b>451</b>
<b>Total risk provision for loans and advances</b>	<b>(225,808)</b>	<b>(72,854)</b>

The total loss from the endpayment is 57.5 billion forint. The realised portion of 28 billion forint is recognised in 'Direct write-off of loans and advances'. The non-realised portion is included in allocation.

### 5) General administrative expenses

in HUF million	2011	2010
Personnel expenses	(26,532)	(28,999)
Other administrative expenses	(27,940)	(26,703)
Depreciation and amortisation	(5,163)	(4,890)
<b>Total</b>	<b>(59,635)</b>	<b>(60,592)</b>

#### Personnel expenses

in HUF million	2011	2010
Wages and salaries	(18,809)	(20,015)
Compulsory social security contributions	(5,307)	(6,101)
Other personnel expenses	(2,416)	(2,883)
<b>Total</b>	<b>(26,532)</b>	<b>(28,999)</b>

**Year-end number and average number of employees**

<b>in Full Time Employee</b>	<b>2011 year end</b>	<b>2011 average</b>	<b>2010 year end</b>	<b>2010 average</b>
Erste Bank Hungary	2,591.2	2,559.2	2,525.6	2,713.9
Fully consolidated subsidiaries	357.3	392.9	374.5	386.3
Erste Befektetési Zrt.	110.5	131.2	143.0	136.0
Portfólió Szolgáltató Kft.	15.0	14.8	15.0	15.2
Erste Leasing Autófinanszírozási Zrt.	157.5	173.1	175.5	185.8
Erste Leasing Bérlet Szolgáltató Kft.	2.0	2.4	3.0	2.9
Erste Leasing Eszközfinanszírozási Zrt.	2.0	2.6	3.0	10.4
Erste Faktor Zrt.	13.5	14.3	14.0	13.9
Erste Ingatlanlizing Zrt. <sup>1)</sup>	2.5	7.0	12.0	12.3
Erste Lakáslizing Zrt. <sup>1)</sup>	9.0	9.0	0.0	0.0
Erste Ingatlan Kft.	8.5	8.1	8.0	7.8
Erste Kereskedőház Kft.	0.5	0.7	1.0	2.0
Erste Lakás-takarékpénztár Zrt. <sup>2)</sup>	16.5	8.4	0.0	0.0
Magyar Factor Zrt. <sup>3)</sup>	19.8	21.3	0.0	0.0
<b>Total</b>	<b>2,948.5</b>	<b>2,952.1</b>	<b>2,900.1</b>	<b>3,100.2</b>

1) in 2010 Erste Lakáslizing Zrt.'s activity was supported by Erste Ingatlanlizing Zrt's employees

2) Erste Lakás-takarékpénztár Zrt. established in 2011

3) Magyar Factor Zrt. acquired in 2011

**Other administrative expenses**

<b>in HUF million</b>	<b>2011</b>	<b>2010</b>
IT expenses	(5,761)	(4,705)
Expenses for office space	(11,174)	(9,510)
Office operating expenses	(3,267)	(4,094)
Advertising/marketing	(3,939)	(4,681)
Legal and consulting costs	(1,585)	(1,004)
Sundry administrative expenses	(2,214)	(2,709)
<b>Total</b>	<b>(27,940)</b>	<b>(26,703)</b>

**Depreciation and amortisation**

<b>in HUF million</b>	<b>2011</b>	<b>2010</b>
Software and other intangible assets	(2,341)	(2,447)
Real estate used by Erste Hungary	(589)	(551)
Office and plant equipment	(2,233)	(1,892)
<b>Total</b>	<b>(5,163)</b>	<b>(4,890)</b>

**6) Other operating result**

in HUF million	2011	2010
Other operating income	2,711	2,647
Result from sales of properties/moveables	(62)	(57)
(Allocation)/release of other provisions/risks	(1,276)	206
Expenses for deposit insurance contributions	(711)	(309)
Other taxes	(1,078)	(1,269)
Banking tax <sup>1)</sup>	0	(13,979)
Expenses related to workout activities	(3,353)	(2,124)
Impairment on inventories and receivables	(6,898)	(1,180)
Other operating expenses	(4,848)	(3,155)
<b>Total</b>	<b>(15,515)</b>	<b>(19,220)</b>

1) Losses generated by the endpayment law can be reclaimed from 2011 banking tax, up to 30% of the recognised loss. Therefore Erste Hungary shows nil banking tax in the 2011 income statement. Details of endpayment and other legal relevancies see in Note VI. D., page 14-15

**7) 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.

From 2010 a 19% corporate income rate is applicable to all companies. Depending on the level of profitability from the second half of 2010 the tax rate has been reduced to minimum of 10% of the adjusted amount of profit before tax. The part 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 part of the profit above 500 million forint.

Assumption of tax rate was 10% for 2011 at the end of 2010, so deferred tax was calculated by 10% as well. As the rule changed, the rate remained 19% and deferred tax was calculated by 19% again in 2011.

in HUF million	2011	2010
<b>Current tax expense / income</b>		
Current period taxes	(5,100)	(6,350)
of which local business tax	(3,869)	(5,033)
of which local innovation tax	(576)	(748)
<b>Deferred tax expense / income</b>		
Current period deferred tax	(392)	245
<b>Total</b>	<b>(5,492)</b>	<b>(6,105)</b>

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

in HUF million	2011	2010
<b>Loss before tax</b>	<b>(143,911)</b>	<b>4,119</b>
At statutory income tax rate (19%)	27,343	(783)
Income not subject to tax	1,122	853
Non tax deductible expenses	(6,597)	(1,403)
Local business and innovation tax	(4,445)	(5,781)
Effect of positive tax base of subsidiaries	(644)	(1,164)
Tax losses (not recognised) / tax losses carried forward	(22,009)	82
Effect of change in tax rate	(558)	1,002
Other	297	1,088
<b>Total tax losses</b>	<b>(5,492)</b>	<b>(6,105)</b>

Under current national legislation the use of tax losses carried forward is not limited in time.

**8) Cash and balances with central banks**

in HUF million	2011	2010	As at 1 January 2010
Cash in hand	16,773	17,511	16,850
Balances with central banks	311,389	94,083	54,542
<b>Total</b>	<b>328,162</b>	<b>111,594</b>	<b>71,392</b>

Mandatory minimum reserves are also shown under this position:

the Bank is obliged to keep a minimum reserve at the central bank amounting to 2% 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 1 January 2010, 31 December 2010 and 31 December 2011 were 21.4 billion forint, 32.2 billion forint and 39.4 billion forint respectively.

**9) Loans and advances to credit institutions**

in HUF million	2011	2010	As at 1 January 2010
Loans and advances to domestic credit institutions	4,642	28,879	22,129
Loans and advances to foreign credit institutions	221,467	90,233	8,593
of which loans and advances to Austrian credit institutions	218,920	88,763	7,223
<b>Total</b>	<b>226,109</b>	<b>119,112</b>	<b>30,722</b>

**10) Loans and advances to customers**

in HUF million	2011	2010	As at 1 January 2010
<b>Loans and advances to domestic customers</b>	<b>2,290,420</b>	<b>2,242,976</b>	<b>2,060,472</b>
Public sector	64,905	28,336	23,341
Commercial customers	694,813	697,735	720,188
Private customers	1,423,338	1,404,133	1,225,985
Unlisted securities	89,458	99,034	80,142
Other financial institutions	15,472	9,907	5,830
Other	2,434	3,831	4,986
<b>Loans and advances to foreign customers</b>	<b>19,332</b>	<b>15,230</b>	<b>13,435</b>
Commercial customers	15,783	11,607	10,286
Private customers	3,549	3,505	3,080
Other	0	118	69
<b>Total</b>	<b>2,309,752</b>	<b>2,258,206</b>	<b>2,073,907</b>

## 11) Risk provisions for loans and advances

### Risk provisions 2011

in HUF million	01.01.2011	Acquisition/ disposal of subsidiaries	Allocation	Use	Release	Interest income from impaired loans	Exchange rate effect	31.12.2011
Specific provisions	121,877	898	174,534	(9,398)	(15,724)	(7,193)	13,427	278,421
Portfolio provisions	21,172	0	46,790	0	(13,676)	0	1,451	55,737
<b>Risk provisions for loans and advances</b>	<b>143,049</b>	<b>898</b>	<b>221,324</b>	<b>(9,398)</b>	<b>(29,400)</b>	<b>(7,193)</b>	<b>14,878</b>	<b>334,158</b>

### Risk provisions 2010

in HUF million	01.01.2010	Acquisition/ disposal of subsidiaries	Allocation	Use	Release	Interest income from impaired loans	Exchange rate effect	31.12.2010
Specific provisions	64,502	0	69,504	(7,630)	(7,984)	(2,629)	6,113	121,876
Portfolio provisions	12,263	0	14,175		(6,461)	0	1,196	21,173
<b>Risk provisions for loans and advances</b>	<b>76,765</b>	<b>0</b>	<b>83,679</b>	<b>(7,630)</b>	<b>(14,445)</b>	<b>(2,629)</b>	<b>7,309</b>	<b>143,049</b>

## 12) Derivative financial instruments

in HUF million	2011			2010			As at 1 January 2010		
	Notional amount	Fair value		Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative		Positive	Negative
Interest rate swaps	891,617	10,527	35,922	576,786	4,598	38,134	457,039	9,938	20,493
Currency swaps	478,405	3,726	9,989	621,665	2,759	14,510	656,272	5,573	5,231
Interest forward rate agreement	110,000	185	160	148,000	110	95	557,000	674	649
Currency forward rate agreement	213,729	4,400	376	158,502	1,653	379	150,525	397	1,921
Currency futures	8,052	135	17	7,275	72	10	9,709	32	144
Interest rate options	10,343	33	33	9,762	80	80	0	0	0
Currency options	12,647	2,382	2,381	10,806	1,052	1,052	5,461	1,006	1,005
Other agreements	5,938	240	95	10,433	181	248	31,296	420	168
<b>Total derivatives</b>	<b>1,730,731</b>	<b>21,628</b>	<b>48,973</b>	<b>1,543,229</b>	<b>10,505</b>	<b>54,508</b>	<b>1,867,302</b>	<b>18,040</b>	<b>29,611</b>

Net option premium in 2011 is 171 million forint, in 2010 (424) million forint.

### 13) Securities

in HUF million	Bonds and other interest bearing securities			Shares and other equity-related securities			Total securities		
	2011	2010	As at 1 January 2010	2011	2010	As at 1 January 2010	2011	2010	As at 1 January 2010
	<b>Loans and advances</b>	<b>89,458</b>	<b>99,034</b>	<b>80,142</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>89,458</b>	<b>99,034</b>
Listed	0	0	0	0	0	0	0	0	0
Unlisted	89,458	99,034	80,142	0	0	0	89,458	99,034	80,142
<b>Trading assets</b>	<b>137,832</b>	<b>186,342</b>	<b>356,591</b>	<b>3,803</b>	<b>2,548</b>	<b>1,281</b>	<b>141,635</b>	<b>188,890</b>	<b>357,872</b>
Listed	111,231	144,443	314,524	3,424	2,526	962	114,655	146,970	315,487
Unlisted	26,601	41,899	42,067	380	22	319	26,980	41,921	42,386
<b>Financial assets - Available for sale</b>	<b>159,944</b>	<b>31,107</b>	<b>1,092</b>	<b>871</b>	<b>871</b>	<b>871</b>	<b>160,814</b>	<b>31,978</b>	<b>1,963</b>
Listed	159,943	31,107	1,092	0	0	0	159,943	31,107	1,092
Unlisted	0	0	0	871	871	871	871	871	871
<b>Financial assets - Held to maturity</b>	<b>314,002</b>	<b>320,120</b>	<b>293,106</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>314,002</b>	<b>320,120</b>	<b>293,106</b>
Listed	313,458	319,900	261,735	0	0	0	313,458	319,900	261,735
Unlisted	544	220	31,371	0	0	0	544	220	31,371
<b>Total securities</b>	<b>701,236</b>	<b>636,603</b>	<b>730,932</b>	<b>4,674</b>	<b>3,419</b>	<b>2,152</b>	<b>705,909</b>	<b>640,022</b>	<b>733,084</b>

'Bonds and other interest bearing securities' contain the municipality bonds, within the 'Loans and advances balance classification.

Unlisted 'Financial assets - Available for sale' include other investments.

'Held to maturity' and 'Available for sale portfolio mainly contains Hungarian government bonds and central bank bonds. Trading portfolio is dominated by these two types of securities, beside Hungarian blue chip companies' securities in the telecommunication, energy and pharmaceutical industries.

in HUF million	2011	2010	As at 1 January 2010
<b>Financial assets - Available for sale</b>	<b>159,943</b>	<b>31,107</b>	<b>1,092</b>
Hungarian Government bonds	55	1,049	1,092
Hungarian National Bank bonds	159,888	30,058	0
<b>Financial assets - Held to maturity</b>	<b>314,002</b>	<b>320,120</b>	<b>293,106</b>
Hungarian Government bonds	313,802	320,120	293,106
Hungarian National Bank bonds	200	0	0
<b>Trading assets</b>	<b>137,832</b>	<b>186,342</b>	<b>356,591</b>
Hungarian Government bonds	28,637	50,147	36,630
Hungarian National Bank bonds	102,647	128,306	312,828
Banking and corporate bonds	2,746	5,341	5,852
Shares	3,424	2,526	962
Funds	380	22	319

**14) Movements in fixed assets schedule**  
**Movements in fixed assets schedule 2011**

<b>COST in HUF million</b>	<b>Software acquired</b>	<b>Other intangible assets (licenses, patents, etc.)</b>	<b>Own land and buildings</b>	<b>Office and plant equipment/o ther fixed assets</b>	<b>IT-assets (hardware)</b>	<b>Subtotal</b>
<b>Value 01.01.2011</b>	<b>25,632</b>	<b>1,117</b>	<b>9,970</b>	<b>7,278</b>	<b>9,799</b>	<b>53,797</b>
Additions	7,364	2	1,992	811	1,410	11,580
Disposals	(10,334)	(3)	(1,982)	(1,497)	(358)	(14,174)
Reclassification	19	2	0	(1)	(20)	0
Addition to group	342	0	0	42	35	420
<b>Value 31.12.2011</b>	<b>23,023</b>	<b>1,119</b>	<b>9,980</b>	<b>6,634</b>	<b>10,867</b>	<b>51,623</b>

<b>DEPRECIATION AND IMPAIRMENT in HUF million</b>	<b>Software acquired</b>	<b>Other intangible assets (licenses, patents, etc.)</b>	<b>Own land and buildings</b>	<b>Office and plant equipment/ot her fixed assets</b>	<b>IT-assets (hardware)</b>	<b>Subtotal</b>
<b>Value 01.01.2011</b>	<b>15,031</b>	<b>684</b>	<b>2,688</b>	<b>4,896</b>	<b>6,520</b>	<b>29,819</b>
Additions	2,583	159	1,607	870	1,417	6,636
Disposals	(6,234)	(2)	(927)	(1,267)	(353)	(8,783)
Reclassification	12	0	0	0	(12)	0
Addition to group	143	0	0	22	32	197
<b>Value 31.12.2011</b>	<b>11,536</b>	<b>841</b>	<b>3,368</b>	<b>4,521</b>	<b>7,604</b>	<b>27,869</b>

<b>NET CARRYING AMOUNT in HUF million</b>	<b>Software acquired</b>	<b>Other intangible assets (licenses, patents, etc.)</b>	<b>Own land and buildings</b>	<b>Office and plant equipment/ot her fixed assets</b>	<b>IT-assets (hardware)</b>	<b>Subtotal</b>
<b>Value 01.01.2011</b>	<b>10,600</b>	<b>434</b>	<b>7,283</b>	<b>2,382</b>	<b>3,279</b>	<b>23,978</b>
<b>Value 31.12.2011</b>	<b>11,487</b>	<b>278</b>	<b>6,613</b>	<b>2,113</b>	<b>3,263</b>	<b>23,754</b>

### Movements in fixed assets schedule 2010

<b>COST</b> in HUF million	<b>Software acquired</b>	<b>Other intangible assets (licenses, patents, etc.)</b>	<b>Own land and buildings</b>	<b>Office and plant equipment/ot her fixed assets</b>	<b>IT-assets (hardware)</b>	<b>Subtotal</b>
<b>Value 01.01.2010</b>	23,172	906	10,169	6,522	8,950	49,718
Additions	3,060	212	753	1,198	1,268	6,490
Disposals	(580)	(2)	(954)	(442)	(434)	(2,412)
Reclassification	(20)	2	2	(1)	16	0
<b>Value 31.12.2010</b>	<b>25,632</b>	<b>1,117</b>	<b>9,970</b>	<b>7,278</b>	<b>9,799</b>	<b>53,797</b>

<b>DEPRECIATION AND IMPAIRMENT</b> in HUF million	<b>Software acquired</b>	<b>Other intangible assets (licenses, patents, etc.)</b>	<b>Own land and buildings</b>	<b>Office and plant equipment/ot her fixed assets</b>	<b>IT-assets (hardware)</b>	<b>Subtotal</b>
<b>Value 01.01.2010</b>	12,960	522	2,517	4,632	5,651	26,282
Additions	2,282	162	551	599	1,295	4,890
Disposals	(204)	(1)	(380)	(335)	(432)	(1,353)
Reclassification	(6)	0	0	0	6	0
<b>Value 31.12.2010</b>	<b>15,031</b>	<b>684</b>	<b>2,688</b>	<b>4,896</b>	<b>6,520</b>	<b>29,819</b>

<b>NET CARRYING AMOUNT</b> in HUF million	<b>Software acquired</b>	<b>Other intangible assets (licenses, patents, etc.)</b>	<b>Own land and buildings</b>	<b>Office and plant equipment/ot her fixed assets</b>	<b>IT-assets (hardware)</b>	<b>Subtotal</b>
<b>Value 01.01.2010</b>	10,212	383	7,652	1,890	3,300	23,437
<b>Value 31.12.2010</b>	<b>10,600</b>	<b>434</b>	<b>7,283</b>	<b>2,382</b>	<b>3,279</b>	<b>23,978</b>

### Net carrying amount

in HUF million	2011	2010	As at 1 January 2010
<b>Intangible assets</b>	<b>11,765</b>	<b>11,034</b>	<b>10,595</b>
Software acquired	11,487	10,600	10,212
Other intangible assets (licenses, patents, etc.)	278	434	383
<b>Property and equipment</b>	<b>11,989</b>	<b>12,944</b>	<b>12,842</b>
Own land and buildings	6,613	7,283	7,652
Office and plant equipment/other fixed assets	2,113	2,382	1,890
IT-assets (hardware)	3,263	3,279	3,299
<b>Total intangible and tangible assets</b>	<b>23,755</b>	<b>23,978</b>	<b>23,437</b>

Within fully amortised intangible assets still in use, Erste Hungary has recognised software with a gross value amounting to 7,593 million forint in 2011, 4,713 million forint in 2010 and 8,322 million forint as at 1 January 2010.

**15) Tax assets and liabilities**

in HUF million	Tax assets 2011	Tax assets 2010	Tax assets as at 1 January 2010	Tax liabilities 2011	Tax liabilities 2010	Tax liabilities as at 1 January 2010
Deferred taxes	58	759	2,019	(366)	(634)	(2,144)
Loans and advances to credit institutions and customers	(19)	(26)	(68)	(3,133)	(960)	(1,445)
Risk provisions for loans and advances	0	479	1,231	2,679	(17)	(943)
Trading assets	3	0	0	0	(23)	8
Financial assets - available for sale	0	0	0	4	0	(4)
Financial assets - held to maturity	0	0	0	(141)	368	23
Property and equipment	5	(13)	(71)	130	(74)	(110)
Deposits by banks and customer deposits	0	(69)	(161)	71	59	143
Trading liabilities	0	0	0	0	0	0
Sundry provisions	48	0	0	7	0	(49)
Tax loss carry forward	6	351	1,091	0	0	0
Intangible assets	(8)	0	0	0	(20)	(38)
Other	23	37	(3)	17	33	271
Current taxes	1,451	2,273	2,327	182	161	36
<b>Total taxes</b>	<b>1,509</b>	<b>3,032</b>	<b>4,346</b>	<b>(184)</b>	<b>(473)</b>	<b>(2,108)</b>

**16) Assets classified as held for sale**

in HUF million	2011	2010	As at 1 January 2010
Assets classified as held for sale	1,564	2,124	2,850

In 'Assets classified as held for sale' Erste Hungary includes repossessed cars relating to the leasing companies' activity.

**17) Other assets**

in HUF million	2011	2010	As at 1 January 2010
Clearing accounts with tax authorities	14,756	118	352
Other clearing accounts	4,042	4,294	1,960
Receivables from sales and services	2,117	3,643	2,194
Other accrued income	1,069	1,856	4,474
Inventories	443	5,092	0
Repossessed assets	26,510	9,592	4,882
Prepaid expenses	1,015	835	688
Other assets held for rental income	282	523	1,137
Other	2,928	1,109	1,992
<b>Total</b>	<b>53,162</b>	<b>27,062</b>	<b>17,679</b>

Clearing accounts with tax authorities' contains the receivable of banking tax of 14.7 billion forint.

Repossessed assets are mainly properties, 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 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 business use.

## 18) Deposits by banks

in HUF million	2011	2010	As at 1 January 2010
Deposits by domestic banks	109,680	120,081	87,150
Deposits by foreign banks	1,574,705	1,399,575	1,252,421
of which Deposits by Austrian banks	1,497,472	1,320,554	1,212,961
<b>Total</b>	<b>1,684,385</b>	<b>1,519,656</b>	<b>1,339,571</b>

## 19) Customer deposits

in HUF million	Domestic 2011	Domestic 2010	Domestic as at 1 January 2010	Foreign 2011	Foreign 2010	Foreign as at 1 January 2010	Total 2011	Total 2010	Total as at 1 January 2010
Savings deposits	2,422	2,453	2,494	0	0	0	2,422	2,453	2,494
Other deposits	1,165,816	1,060,109	1,102,233	33,640	30,170	32,351	1,199,455	1,090,279	1,134,584
Public sector	44,872	51,188	60,990	0	0	0	44,872	51,188	60,990
Commercial customers	297,162	274,320	261,170	9,576	9,712	10,205	306,738	284,032	271,375
Private customers	633,455	564,608	619,348	22,929	19,580	21,212	656,385	584,188	640,559
Other financial institutions	145,506	134,989	130,862	0	2	2	145,506	134,991	130,864
Other	44,821	35,004	29,863	1,135	876	932	45,954	35,880	30,796
<b>Total</b>	<b>1,168,238</b>	<b>1,062,562</b>	<b>1,104,727</b>	<b>33,640</b>	<b>30,170</b>	<b>32,351</b>	<b>1,201,878</b>	<b>1,092,732</b>	<b>1,137,078</b>

## 20) Debt securities in issue

in HUF million	2011	2010	As at 1 January 2010
Bonds	3,907	24,938	30,836
at notional value	3,958	24,152	31,928
Certificates of deposit	881	939	1,028
<b>Total</b>	<b>4,788</b>	<b>25,877</b>	<b>31,864</b>

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

Issued securities as at 31 December 2011	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Currency	Interest conditions
ERSTE FIX 11/B KÖTVÉNY	HU0000343751	7 May 2009	12 June 2012	1,953	HUF	zero coupon bond, rate of issue: 72.3296%
HOZAMGARANTÁLT KÖTVÉNY 2.	HU0000343785	28 May 2009	3 January 2012	1,505	HUF	zero coupon bond, rate of issue: 79.9077%
EURÓPA BAJNOK KÖTVÉNY	HU0000343793	2 June 2009	2 June 2014	500	HUF	floating (linked to 'DJ Eurostoxx 50 Index')
<b>Total</b>				<b>3,958</b>		

Issued securities as at 31 December 2010	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Curr ency	Interest conditions
ERSTE FIX 10/B KÖTVÉNY	HU0000343769	7 May 2009	22 April 2011	3,906	HUF	zero coupon bond, rate of issue: 82.969%
ERSTE FIX 11/B KÖTVÉNY	HU0000343751	7 May 2009	12 June 2012	1,953	HUF	zero coupon bond, rate of issue: 72.3296%
ERSTE FIX11 KÖTVÉNY	HU0000343462	16 December 2008	16 February 2011	2,539	HUF	zero coupon bond, rate of issue: 79.7362%
ERSTE FIX9 KÖTVÉNY	HU0000343595	4 March 2009	22 April 2011	3,909	HUF	zero coupon bond, rate of issue: 83.1999%
ERSTE FIX9/B KÖTVÉNY	HU0000343983	17 June 2009	17 June 2011	1,030	HUF	zero coupon bond, rate of issue: 84.168%
ERSTE HOZAMVÁRÓ KÖTVÉNY 2.	HU0000343157	5 November 2008	5 May 2011	502	HUF	floating (linked to 'DB Liquid Alpha 4 EUR')
ERSTE HOZAMVÁRÓ KÖTVÉNY 3.	HU0000343306	3 December 2008	3 June 2011	615	HUF	floating (linked to 'DB Liquid Alpha 4 EUR')
EURÓPA BAJNOK KÖTVÉNY	HU0000343793	2 June 2009	2 June 2014	500	HUF	floating (linked to 'DJ Eurostoxx 50 Index')
HOZAMGARANTÁLT KÖTVÉNY 2.	HU0000343785	28 May 2009	3 January 2012	1,505	HUF	zero coupon bond, rate of issue: 79.9077%
SIKER GARANTÁLT KÖTVÉNY 3.	HU0000342993	17 September 2008	11 January 2011	6,278	HUF	floating (linked to 'DB Liquid Alpha 4 EUR')
SIKER GARANTÁLT KÖTVÉNY 4.	HU0000343397	16 December 2008	16 June 2011	1,414	HUF	floating (linked to 'SP GSCI GOLD Excess Return Index')
<b>Total</b>				<b>24,152</b>		

Issued securities as at 1 January 2010	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Curre ncy	Interest conditions
ERSTE FIX 10/B KÖTVÉNY	HU0000343769	7 May 2009	22 April 2011	3,906	HUF	zero coupon bond, rate of issue: 82.969%
ERSTE FIX 11/B KÖTVÉNY	HU0000343751	7 May 2009	12 June 2012	1,953	HUF	zero coupon bond, rate of issue: 72.3296%
ERSTE FIX10 KÖTVÉNY	HU0000343389	16 December 2008	16 April 2010	2,753	HUF	zero coupon bond, rate of issue: 88.0816%
ERSTE FIX11 KÖTVÉNY	HU0000343462	16 December 2008	16 February 2011	2,539	HUF	zero coupon bond, rate of issue: 79.7362%
ERSTE FIX9 KÖTVÉNY	HU0000343595	4 March 2009	22 April 2011	3,909	HUF	zero coupon bond, rate of issue: 83.1999%
ERSTE FIX9/B KÖTVÉNY	HU0000343983	17 June 2009	17 June 2011	1,030	HUF	zero coupon bond, rate of issue: 84.168%
ERSTE HOZAMVÁRÓ KÖTVÉNY	HU0000342910	3 September 2008	3 September 2010	2,792	HUF	floating (linked to 'DB Liquid Alpha 4 EUR')
ERSTE HOZAMVÁRÓ KÖTVÉNY 2.	HU0000343157	5 November 2008	5 May 2011	502	HUF	floating (linked to 'DB Liquid Alpha 4 EUR')
ERSTE HOZAMVÁRÓ KÖTVÉNY 3.	HU0000343306	3 December 2008	3 June 2011	615	HUF	floating (linked to 'DB Liquid Alpha 4 EUR')
EURÓPA BAJNOK KÖTVÉNY	HU0000343793	2 June 2009	2 June 2014	500	HUF	floating (linked to 'DJ Eurostoxx 50 Index')
HOZAMGARANTÁLT KÖTVÉNY	HU0000343603	4 March 2009	12 October 2010	2,055	HUF	zero coupon bond, rate of issue: 88.3585%
HOZAMGARANTÁLT KÖTVÉNY 2.	HU0000343785	28 May 2009	3 January 2012	1,505	HUF	zero coupon bond, rate of issue: 79.9077%
SIKER GARANTÁLT KÖTVÉNY 3.	HU0000342993	17 September 2008	11 January 2011	6,453	HUF	floating (linked to 'DB Liquid Alpha 4 EUR')
SIKER GARANTÁLT KÖTVÉNY 4.	HU0000343397	16 December 2008	16 June 2011	1,414	HUF	floating (linked to 'SP GSCI GOLD Excess Return Index')
<b>Total</b>				<b>31,928</b>		

**21) Trading liabilities**

in HUF million	2011	2010	As at 1 January 2010
Short position	13	7,708	12,731
<b>Total</b>	<b>13</b>	<b>7,708</b>	<b>12,731</b>

The short position consists of securities that have been acquired principally for the purpose of selling and/or repurchasing in the near term.

**22) Sundry provisions**

in HUF million	2011	2010	As at 1 January 2010
Provision for guarantees	518	1,103	1,517
Provision as a precaution	610	625	712
<b>Sundry provision related to loans and advances</b>	<b>1,128</b>	<b>1,728</b>	<b>2,229</b>
Provision for litigations	1,188	1,358	1,292
Provision for restructuring	5,733	1,787	0
Other provision	1,356	0	266
<b>Total</b>	<b>9,405</b>	<b>4,873</b>	<b>3,787</b>

*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.

*Provision for restructuring*

In 2011 Erste Hungary communicated that it planned a restructuring of its operations necessitated from the cumulative effects of the unfavourable economic tendencies, limited future income expectations, the imposed banking tax and losses resulting from the endpayment law. The 2011 plan was an additional step to the reorganisation already commenced in 2010 that included both redundancy and branch closures.

The restructuring conception was accompanied by a redundancy plan impacting 380 employee positions. As positions were vacant at that time, some employees went into maternity leave and a group of employees were eligible for retirement, overall redundancies were reduced to 307 employees.

As another pillar of the restructuring plan, the Bank optimised its branch network, as announced in 2011. At the beginning of January 2012 the Bank's network consisted of 143 branches, whereas prior to the restructuring it previously had 184 branches.

in HUF million	01.01.2011	Allocations	Use	Releases	Exchange rate changes	31.12.2011
Provision for guarantees	1,103	330	0	(897)	(18)	518
Provision as a precaution	625	16	0	(2)	(29)	610
Other sundry provisions	3,145	7,113	(1,539)	(362)	(80)	8,277
<b>Total</b>	<b>4,873</b>	<b>7,459</b>	<b>(1,539)</b>	<b>(1,261)</b>	<b>(127)</b>	<b>9,405</b>

in HUF million	01.01.2010	Allocations	Use	Releases	Exchange rate changes	31.12.2010
Provision for guarantees	1,517	1,439	0	(1,802)	(51)	1,103
Provision as a precaution	712	2	0	(89)	0	625
Other sundry provisions	1,558	1,882	0	(291)	(4)	3,145
<b>Total</b>	<b>3,787</b>	<b>3,323</b>	<b>0</b>	<b>(2,182)</b>	<b>(55)</b>	<b>4,873</b>

### 23) Other liabilities

in HUF million	2011	2010	As at 1 January 2010
Deferred income	43	49	54
Clearing accounts	24,906	10,048	7,706
Tax liabilities	275	2,188	7,957
Payment accounts from sales and services	2,516	3,555	2,288
Received payments on advance	177	98	76
Accruals of other expenses	4,831	8,532	7,314
Other liabilities	3,528	438	68
<b>Total</b>	<b>36,276</b>	<b>24,908</b>	<b>25,463</b>

### 24) Subordinated liabilities

in HUF million	2011	2010	As at 1 January 2010
Securities as subordinated liabilities	2,411	2,334	2,250
at notional value	2,163	2,163	2,163
Loans as subordinated liabilities	81,469	72,983	70,911
at notional value	81,454	72,977	70,906
<b>Subordinated liabilities</b>	<b>83,880</b>	<b>75,317</b>	<b>73,161</b>

### Subordinated liabilities as of 31 December 2011 – securities

Issuer	Notional amount in HUF million	Date of issue	Maturity date	Interest conditions
Mezőbank - legal predecessor	300	31 May 1994	31 May 2014	based on the conditions of consolidated government bonds 2014/A
Agrobank - legal predecessor	500	31 May 1994	31 May 2014	based on the conditions of consolidated government bonds 2014/A
Agrobank - legal predecessor	500	20 June 1995	20 Dec 2014	based on the conditions of consolidated government bonds 2014/B
Erste Bank Hungary Ltd.	389	1 Dec 2008	1 Dec 2020	fixed, interest 122.22%, payable at maturity
Erste Bank Hungary Ltd.	474	30 Apr 2009	30 Apr 2019	fixed, interest 119.7802%, payable at maturity
<b>Total subordinated securities</b>	<b>2,163</b>			

**Subordinated liabilities as of 31 December 2011 – loans**

Erste Group Bank AG provided subordinated loans as follows:

Maturity	Notional amount in thousand EUR	2011 in million HUF	2010 in million HUF	As at 1 January 2010 in million HUF	Interest conditions
31 December 2012	161,800	50,341	45,102	43,822	EURIBOR + 0.75%, quarterly
31 December 2018	100,000	31,113	27,875	27,084	EURIBOR + 3.93%, quarterly
<b>Total subordinated loans</b>	<b>261,800</b>	<b>81,454</b>	<b>72,977</b>	<b>70,906</b>	

**25) Total equity**

in HUF million	2011	2010	As at 1 January 2010
Subscribed capital	100,000	60,910	60,910
Additional paid-in capital	151,359	10,449	10,449
Retained earnings and other reserves	(73,568)	75,852	91,721
Owners of the parent	177,791	147,211	163,080
Non-controlling interests	0	(32)	26
<b>Total</b>	<b>177,791</b>	<b>147,179</b>	<b>163,105</b>

*Owners of the Bank*

Until 26 November 2010 the shares of the Bank were held by EGB Ceps Holding GmbH, and other international investors, as well as domestic institutional and private investors.

On 26 November 2010 EGB Ceps Holding GmbH, exercising its purchase right ensured by Section 76/D of the Capital Markets Act, acquired all the shares issued by the Bank.

The ownership structure of the Bank is as follows:

	2011	2010	As at 1 January 2010
<b>EGB Ceps Holding GmbH</b>	100%	100%	99.95%
<b>Other owners – domestic</b>	-	-	0.009%
<b>Other owners – foreign</b>	-	-	0.041%

The total share capital consists of both ordinary shares and dividend preference shares. Dividend preference shares (DPS) are not entitled to any voting right. In a given year the dividend payable for DPS is 150% of the dividend on ordinary shares, unless the Board of Directors, as entitled by the Shareholder, defines it at a lower level. As the legal conditions of dividend payment are fulfilled in a given year, the dividend paid on DPS is the minimum of 2.5% of the face value of the share. The dividend right on DPS are not cumulative and must be separately approved each year.

*Subscribed capital and Additional paid in capital*

On 24 April 2009 the General Meeting of the Company increased the equity of the Company by 7.5 billion forint to 60,909,541,971 forint, from 53,409,541,971 forint, in the form of a capital increase implemented as a private issuance of new shares. At 1 January 2010 the Bank held 60.91 billion forint subscribed capital.

On 21 November 2011 Erste Bank Hungary Zrt. announced that the single shareholder has increased its equity by 39,090,458,029 forint to 100 billion forint from 60.91 billion forint, in the form of a capital increase implemented as a private issuance of new shares, and consisting of dematerialized ordinary shares of 1 forint nominal value each. The issuance value of shares was 4.604704296 forint each. The purchase price of the new shares (the total issuance value) was 180 billion forint and was settled by way of financial contribution. The full purchase price of the shares (the total issuance value) was settled by the Shareholder on 3 November 2011.

The Bank's subscribed capital of 100 billion forint is exclusively made up from financial contributions consisting of 99,999,646,458 forint registered ordinary shares with a nominal value of 1 forint each and 353,542 registered dividend preference shares with a nominal value of 1 forint each. The total subscribed capital of the Bank has been fully paid.

Both at 1 January 2010 and 31 December 2010 the Bank's subscribed capital was 60,909,541,971 forint registered ordinary shares, consisting of 60,909,188,429 shares with a nominal value of 1 forint each and 353,542 forint registered dividend preference shares with a nominal value of 1 forint each.

#### *Retained earnings and other reserves*

Within 'Retained earnings and other reserves' the Bank records both a 'General Risk Reserve' and a 'General Reserve'. Section 81 of the Credit Institutions and Financial Enterprises Act allows the Bank to allocate a 'General Risk Reserve' amounting to 1.25% of total risk weighted assets. The Bank decided that it would not allocate further 'General Risk Reserves' after 1 January 2001. The total amount of 1,422 million forint allocated before 1 January 2001 was used in 2011 for losses incurred on 'Loans and advances'. Section 75 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. Any use of the reserve needs to be in connection to losses on the Bank's core activity. In 2011 the Bank used the total General Reserve of 12,230 billion forint.

#### *Dividend*

By the decision of the Board of Directors the Bank paid a dividend in the amount of 13.92 billion forint based on its 2009 profit of 16.90 billion forint. The dividend was defined at 22.85% of the nominal value of ordinary shares and 34.28% of the nominal value of dividend preference shares.

Dividends are paid to shareholders based on the following connective conditions:

- at the date of the shareholders' meeting the shareholder held the entitling share on his security account
- at the date of the shareholders' meeting the shareholder is registered in the share-register.

The right for the voted dividend is exercisable within 5 years from the published starting date of the dividend payment.

#### *Non-controlling interests*

By purchasing 1.96% ownership of Erste Leasing Autófinanszírozási Zrt. from Erste Bank der Österreichischen Sparkassen AG, the Bank became 100% owner of the company. It has no other non-controlling interest in 2011.

#### **Employee share ownership plan (ESOP) and management share option plan (MSOP)**

Under the **ESOP 2011**, between 2 and 13 May 2011, a total of 700 Erste Group shares were subscribed by Erste Hungary's employees at a price of 28 euro (7,485.8 forint at the applicable 15 April 2011 NBH exchange rate of 267.35 HUF/EUR). The resulting issue proceeds of 19,600 euro (5,240,060 forint) plus 4,007.5 euro (1,071,405 forint) (resulting from the difference between the issue price of 28 euro and the quoted price of 33.725 euro (9,016.4 forint) on the 26 May 2011 value date when the shares were subscribed for employees of the Erste Hungary and subsequently charged to personnel expenses in the income statement) totalled 23,607.50 euro (no subscription in 2010).

**MSOP 2005 - 2008:** The MSOP comprises a maximum number of ordinary shares of Erste Group, represented by the same number of options. Altogether 11,005 options were granted in 2005, 11,640 in 2006, 19,185 in 2007 and 18,490 in 2008 to the employees of the Bank and its fully consolidated subsidiaries. The distribution of vested options among management board members, managers and eligible other staff of the Bank and its fully consolidated subsidiaries is shown in the tables below.

**Terms of MSOP 2005 - 2008:** Each of the options, which are granted free of charge, entitles the holder to receive one share; the transfer of options inter vivos is not permitted. The 2005 option grant dates were as follows: for the management board and other managers, 1 June 2005; for other key personnel, the grants occurred in three tranches, on 1 September 2005, 1 September 2006 and 31 August 2007. For all recipients the options were vested in three tranches, at which time they were credited to recipients' accounts: 1 September 2005, 1 September 2006 and 31 August 2007. The exercise price for all three tranches was set at the average market price of Erste Group shares quoted in April 2005 plus a 10% premium, rounded down to the nearest half euro. The resulting exercise price was EUR 43.00 per share. The 2008 option grant date was 1 September 2008 and the exercise price was 47.00 per share. The option term begins at the grant date and ends on the value date of the last exercise window of the fifth calendar year after the year in which the option vested (the end of last exercise window related to the currently outstanding options is November 2013). Every year, notices of intention to exercise may be submitted within 14 days from the day of publication of the quarterly results for the first, second and third quarter of each financial year (three exercise windows per year). The holding period runs for one year from the value date of the share purchase. Up to 25% of the purchased shares may be sold during this holding period.

The **MSOP 2005 - 2008** options granted, vested and exercised had the following distribution among recipients:

in pieces of exercisable options	Outstanding at 01.01.2011	Forfeited in 2011	Expired in 2011	Outstanding at 31.12.2011
Management board members	3,000			3,000
Other staff	33,081	5,290	5,210	22,581
<b>Total options</b>	<b>36,081</b>	<b>5,290</b>	<b>5,210</b>	<b>25,581</b>

In 2010 and 2011 nil options were exercised.

## 26) Segment reporting

The segment reporting of Erste Hungary follows the presentation and measurement requirements of IFRS. For management purposes, the bank is organised into seven 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 1.5 million euro GDP weighted turnover). The Retail business line at Erste Hungary is divided into 7 regions 184 branches (2011).

The relevant results of the leasing companies, property management company (Erste Ingatlan Kft.), building society (Erste Lakás-takarékpénztárt Zrt.), and the pension fund support company (Erste Pénztárszervező Kft.) are also included into this segment.

### Local Corporate

Local Corporate includes business with small and medium sized enterprises, non-profit and public sector. Client segmentation within the SME is the following:

- Small SME (up to 5 million euro GDP weighted turnover)
- Medium SME (up to 30 million euro GDP weighted turnover)
- Large SME (up to 175 million euro GDP weighted turnover)

The relevant results of the leasing companies, factoring companies, property management company (Erste Ingatlan Kft.), and trading company (Erste Kereskedőház Kft.) are also included into this segment.

### Real Estates

Real Estate is a divisionalised business in both Erste Hungary and Erste Group and serves clients that have their core competency in real estate projects. The Real Estate segment consists of Erste Hungary Real Estate Business Line (property leasing companies) and the property management company's relevant result (Erste Ingatlan Kft.).

### Asset and Liability Management (ALM)

Business line ALM is responsible for the management of the following risks:

- Interest Risk - favourable / unfavourable developments of interest rates on the market
- FX Risk - favourable / unfavourable developments of FX rates on the market
- Liquidity Risk - assurance of a sufficient amount of liquidity to satisfy customer claims

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 parts of this segment.

### Corporate Centre

Corporate Centre contains the non-client business of Erste Hungary, such as tangible and intangible assets, other assets and liabilities etc. Consolidation effects and non-allocated subsidiaries like Erste-Dat Kft. and the property management company's corporate centre (Erste Ingatlan Kft.) are also recorded in this segment.

### Group Markets (GCM)

The Group Markets segment comprises the divisionalised business units Group Treasury and Capital Markets (which includes all capital markets activities except equity capital markets). Besides the Bank's own Trading and Sales activities, it also includes the brokerage company (Erste Befektetési Zrt.).

### Group Large Corporate (GLC)

The Group Large Corporate includes all large corporate customers operating in the markets of Erste Group and having revenue of more than 175 million euro. GLC segment consists of the Bank GLC Business Line and the brokerage company (Erste Befektetési Zrt.).

### Free Capital

Free capital is not a segment but 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 2011

in HUF million	Retail	Local corporate	Real estate	ALM	Corporate Centre	GCM	GLC	Free capital	TOTAL
<b>Total Assets</b>	<b>1,294,624</b>	<b>477,302</b>	<b>195,650</b>	<b>625,392</b>	<b>71,770</b>	<b>532,504</b>	<b>50,693</b>	<b>0</b>	<b>3,247,936</b>
<b>Total Liabilities</b>	<b>918,931</b>	<b>440,517</b>	<b>98,646</b>	<b>1,466,136</b>	<b>(94,743)</b>	<b>347,561</b>	<b>44,342</b>	<b>26,545</b>	<b>3,247,936</b>
Net interest income	95,726	16,937	5,227	(5,079)	856	(350)	1,676	1,106	116,100
Net fee and commission income	22,412	4,449	150	(3)	285	1,317	444	0	29,055
Net trading result	1,815	731	166	(114)	771	8,454	67	0	11,891
Risk provisions for loans and advances	(137,095)	(53,417)	(48,232)	0	12,665	0	272	0	(225,808)
General administrative expenses	(47,856)	(7,331)	(1,192)	(89)	651	(3,211)	(608)	0	(59,635)
Other result <sup>1)</sup>	(6,200)	(6,308)	(870)	(33)	(2,025)	(46)	(33)	0	(15,515)
Profit (loss) before tax	(71,198)	(44,937)	(44,751)	(5,317)	13,204	6,164	1,817	1,106	(143,911)
Taxes on income	(9,125)	(525)	(129)	(36)	5,730	(804)	(323)	(279)	(5,492)
<b>Profit (loss) for the year</b>	<b>(80,323)</b>	<b>(45,462)</b>	<b>(44,880)</b>	<b>(5,353)</b>	<b>18,934</b>	<b>5,360</b>	<b>1,494</b>	<b>827</b>	<b>(149,403)</b>
Attributable to:									
Non-controlling interests	0	0	0	0	0	0	0	0	0
<b>Owners of the parent</b>	<b>(80,323)</b>	<b>(45,462)</b>	<b>(44,880)</b>	<b>(5,353)</b>	<b>18,934</b>	<b>5,360</b>	<b>1,494</b>	<b>827</b>	<b>(149,403)</b>
<b>Cost/income ratio</b>	<b>40%</b>	<b>33%</b>	<b>21%</b>	<b>(2)%</b>	<b>(34)%</b>	<b>34%</b>	<b>28%</b>	<b>0%</b>	<b>38%</b>

1) Other result consists of four income statement items: other operating result, result from financial assets at fair value through profit or loss, result from financial assets available for sale, and result from financial assets held to maturity.

**Segment reporting 2010**

in HUF million	Retail	Local corporate	Real estate	ALM	Corporate Centre	GCM	GLC	Free capital	TOTAL
<b>Total Assets</b>	<b>1,387,291</b>	<b>487,682</b>	<b>222,666</b>	<b>455,395</b>	<b>42,012</b>	<b>303,171</b>	<b>55,336</b>	<b>0</b>	<b>2,953,552</b>
<b>Total Liabilities</b>	<b>922,138</b>	<b>402,760</b>	<b>92,790</b>	<b>1,521,327</b>	<b>(190,579)</b>	<b>126,265</b>	<b>42,899</b>	<b>35,951</b>	<b>2,953,552</b>
Net interest income	89,669	16,041	5,980	(6,822)	3,742	(835)	1,692	3,542	113,008
Net fee and commission income	21,412	4,518	197	0	45	1,764	485	0	28,422
Net trading result	2,353	1,517	325	402	4,076	6,560	122	0	15,356
Risk provisions for loans and advances	(38,807)	(19,029)	(8,106)	0	(6,760)	0	(152)	0	(72,854)
General administrative expenses	(48,297)	(6,828)	(999)	(77)	383	(4,182)	(593)	0	(60,592)
Other result <sup>1)</sup>	(1,826)	(1,051)	(182)	(26)	(16,050)	(73)	(13)	0	(19,220)
Profit (loss) before tax	24,504	(4,832)	(2,785)	(6,523)	(14,563)	3,234	1,542	3,542	4,119
Taxes on income	(7,265)	(508)	(150)	0	3,704	(787)	(346)	(754)	(6,105)
<b>Profit (loss) for the year</b>	<b>17,239</b>	<b>(5,340)</b>	<b>(2,934)</b>	<b>(6,523)</b>	<b>(10,859)</b>	<b>2,447</b>	<b>1,196</b>	<b>2,787</b>	<b>(1,986)</b>
Attributable to:									
Non-controlling interests	0	0	0	0	57	0	0	0	57
<b>Owners of the parent</b>	<b>17,239</b>	<b>(5,340)</b>	<b>(2,934)</b>	<b>(6,523)</b>	<b>(10,802)</b>	<b>2,447</b>	<b>1,196</b>	<b>2,787</b>	<b>(1,929)</b>
<b>Cost/income ratio</b>	<b>43%</b>	<b>31%</b>	<b>15%</b>	<b>(1)%</b>	<b>(5)%</b>	<b>56%</b>	<b>26%</b>	<b>0%</b>	<b>39%</b>

1) Other result consists of four income statement items: other operating result, result from financial assets at fair value through profit or loss, result from financial assets available for sale, and result from financial assets held to maturity.

**Segment reporting as at 1 January 2010**

in HUF million	Retail	Local corporate	Real estate	ALM	Corporate Centre	GCM	GLC	Free capital	TOTAL
<b>Total Assets</b>	<b>1,291,887</b>	<b>513,730</b>	<b>226,395</b>	<b>360,640</b>	<b>(93,917)</b>	<b>456,974</b>	<b>62,840</b>	<b>0</b>	<b>2,818,550</b>
<b>Total Liabilities</b>	<b>1,033,572</b>	<b>357,716</b>	<b>70,807</b>	<b>1,330,838</b>	<b>(258,139)</b>	<b>193,268</b>	<b>41,175</b>	<b>49,313</b>	<b>2,818,550</b>

## 27) Assets and liabilities denominated in foreign currencies

Assets and liabilities not denominated in forint were as follows:

in HUF million	of which outside Hungary					
	2011	2010	As at 1 January 2010	2011	2010	As at 1 January 2010
<b>Assets</b>	<b>1,551,953</b>	<b>1,653,082</b>	<b>1,575,562</b>	<b>68,160</b>	<b>26,326</b>	<b>25,230</b>
CHF	493,293	485,260	488,139	19,313	13,914	13,430
EUR	1,025,383	1,155,862	1,060,873	20,101	9,328	9,522
USD	31,222	9,810	24,482	27,474	1,645	1,016
JPY	331	544	639	55	46	58
Other	1,725	1,606	1,429	1,218	1,393	1,204
<b>Liabilities</b>	<b>1,555,285</b>	<b>1,542,391</b>	<b>1,408,960</b>	<b>1,349,592</b>	<b>1,347,325</b>	<b>1,233,948</b>
CHF	825,009	688,624	650,487	667,049	524,731	498,112
EUR	677,271	821,321	733,631	673,989	817,793	731,597
USD	48,442	28,724	21,120	6,791	3,964	3,824
JPY	830	46	33	748	19	8
Other	3,732	3,677	3,689	1,015	817	408

## 28) 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 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	2011	2010	As at 1 January 2010
Outstanding minimum lease payments	52,698	49,703	43,175
Non-guaranteed residual values	2,323	3,057	2,593
<b>Gross investment</b>	<b>55,021</b>	<b>52,759</b>	<b>45,769</b>
Unrealised financial income	16,110	14,501	11,594
<b>Net investment</b>	<b>38,911</b>	<b>38,259</b>	<b>34,175</b>
Present value of non-guaranteed residual values	2,234	2,898	2,442
<b>Present value of minimum lease payments</b>	<b>36,677</b>	<b>35,361</b>	<b>31,733</b>
<b>Risk provision related to outstanding minimum lease payments</b>	<b>(5,481)</b>	<b>(201)</b>	<b>(161)</b>

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		
	2011	2010	As at 1 January 2010	2011	2010	As at 1 January 2010
< 1 year	14,468	13,328	9,016	11,272	9,727	6,774
1-5 years	19,887	19,975	20,520	13,564	14,061	14,771
> 5 years	20,666	19,457	16,233	11,841	11,573	10,188
<b>Total</b>	<b>55,021</b>	<b>52,759</b>	<b>45,769</b>	<b>36,677</b>	<b>35,361</b>	<b>31,733</b>

#### b) Operating leases

##### Erste Hungary as lessor:

in HUF million	2011	2010	As at 1 January 2010
< 1 year	596	1,162	987
1-5 years	87	577	862
> 5 years	0	32	0
<b>Total</b>	<b>683</b>	<b>1,771</b>	<b>1,849</b>

Under operating leases Erste Hungary leases equipment to other parties. Related income is included within 'Interest and similar income'.

##### Erste Hungary as lessee:

in HUF million	2011	2010	As at 1 January 2010
< 1 year	1,519	1,398	1,359
1-5 years	7,596	6,292	6,793
> 5 years	5,317	0	679
<b>Total</b>	<b>14,433</b>	<b>7,690</b>	<b>8,831</b>

Operating leases where Erste Hungary is the lessee comprises the leasing expenses of office space, as included within 'General administrative expenses'. The leasing contract was renewed in June 2011.

#### 29) 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 three periods presented  
 Fellow subsidiaries: all companies consolidated by Erste Group except for both subsidiaries of Erste Hungary's that are eliminated and 'Other investments' as indicated below (see Note 39, list of subsidiaries).

Other investments: being those related parties where the control is less than 20%, (see Note 39, the list of 'Other investments').

**Loans and advances and amounts owed to related parties**

in HUF million	2011	2010	As at 1 January 2010
<b>Loans and advances to credit institutions</b>	<b>218,960</b>	<b>89,150</b>	<b>7,856</b>
Parent	218,699	88,531	7,400
Fellow subsidiaries	261	619	456
<b>Loans and advances to customers</b>	<b>29,976</b>	<b>26,194</b>	<b>21,513</b>
Other Investments	433	411	437
Fellow subsidiaries	29,544	25,783	21,076
<b>Derivative financial instruments - asset</b>	<b>11,526</b>	<b>5,707</b>	<b>13,893</b>
Parent	11,526	5,707	13,893
<b>Deposits by banks</b>	<b>1,499,852</b>	<b>1,321,180</b>	<b>1,213,166</b>
Parent	1,497,472	1,320,551	1,212,869
Fellow subsidiaries	2,381	630	297
<b>Customer deposits</b>	<b>2,939</b>	<b>7,547</b>	<b>8,989</b>
Other Investments	115	523	724
Fellow subsidiaries	2,823	7,024	8,266
<b>Derivative financial instruments - liabilities</b>	<b>47,855</b>	<b>49,161</b>	<b>20,504</b>
Parent	47,855	47,855	47,855
<b>Subordinated liabilities</b>	<b>81,454</b>	<b>72,977</b>	<b>70,906</b>
Parent	81,454	72,977	70,906

**Income and expenses to related parties**

in HUF million	2011	2010
<b>Interest Income</b>	<b>7,454</b>	<b>4,183</b>
Other Investments	15	14
Parent	6,595	3,360
Fellow subsidiaries	844	809
<b>Interest Expense</b>	<b>(35,531)</b>	<b>(29,068)</b>
Other Investments	(1)	(12)
Parent	(35,384)	(28,686)
Fellow subsidiaries	(146)	(369)
<b>Fee and commission income</b>	<b>1,789</b>	<b>1,907</b>
Other Investments	0	469
Parent	1,292	775
Fellow subsidiaries	497	664
<b>Fee and commission expense</b>	<b>(163)</b>	<b>(243)</b>
Other Investments	0	(2)
Parent	(134)	(226)
Fellow subsidiaries	(29)	(14)
<b>Other Income/(Expense)</b>	<b>(294)</b>	<b>(1,222)</b>
Parent	2,201	163
Fellow subsidiaries	(2,495)	(1,385)

## Compensations to Management and Supervisory Board Members and Board of Directors

### Management compensation

in HUF million	2011	2010
Fixed salary	385	322
Performance related compensation	0	406
Fringe benefits	3	4
Other compensation	16	2
<b>Total</b>	<b>404</b>	<b>734</b>

The above includes employment related compensation only; severance payments are not included. There are some overlaps in fixed salary remuneration between departing and joining management members.

In the year under review, management board members that held office in 2011 received remuneration (*including employment related compensation only; severance payments are not included*) totalling 403.8 million forint (2010: 733.6 million forint).

'Other compensation' includes severance payments, daily allowances and other various compensations.

The compensation of management board members is based on the individual's responsibilities, the achievement of corporate targets and the group's financial situation.

From 2011, and in accordance with Erste Hungary's Remuneration Policy – which is based on CRDIII by EU (Capital Requirements Directive III) 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 Group and 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 an 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 2011 performance year. Performance related compensation for 2010 was also paid in upfront and deferred cash payments. Of the total amount above 50,000 euro one-third was deferred for 1 year, and a further one-third of the total amount above 50,000 euro was deferred for 2 years.

Breakdown of Supervisory Board and Board of Directors compensation:

in HUF million	2011	2010
Supervisory Board compensation	64	61
Board of Directors compensation	404	734
<b>Total</b>	<b>468</b>	<b>794</b>

The above includes employment related compensation of Erste Hungary employee members only; severance payments are not included.

Supervisory Board and Board of Directors remuneration includes employment related compensation only (severance payments are not included), received by the local employee members 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 two local employee members and four external members who do not have any functional responsibility within the company.

The Board of Directors of the Bank is set-up of the members of the managerial board and two external members who do not have managerial responsibility within the company. Only one of the external members received compensation in 2011 (4.8 million forint).

There were no other transactions with members of the supervisory board.

### Directorate of Erste Bank Hungary Zrt.

The organisations of the Bank are:

- (i) the Sole Shareholder, which – based on paragraph 2 of section 284 of the Companies Act – exercises the powers of the general meeting;
- (ii) the Board of Directors;
- (iii) the managing directors;
- (iv) the Supervisory Board; and
- (v) the audit committee.

The Sole Shareholder is the supreme body of the Bank, the board of directors and – in cases stipulated by law – the Hungarian Financial Supervisory Authority (HFSA), the Supervisory Board, the auditor, and the Court of Registration may initiate the decision-making of the Sole Shareholder.

### Members of the Board of Directors

The Board of Directors is the managing body of the Bank, which directs the operations of the Bank within the framework of the law, the deed of foundation, and the resolutions of the Sole Shareholder and considering the recommendations of the Supervisory Board.

The Board of Directors consists of 3 (three) to 11 (eleven) members elected by the Sole Shareholder for a maximum of 5 (five) years. The members of the Board of Directors may be re-appointed and revoked at any time by the Sole Shareholder. Such persons may be elected as members of the Board of Directors who comply with the conditions set out in the Companies Act, the Banking Act, other laws, and in Erste Bank Hungary Zrt.'s deed of foundation.

### Members of the Supervisory Board

The Supervisory Board consists of 3 (three) to 9 (nine) members who are elected by the Sole Shareholder for a maximum of 5 (five) years. The members of the Supervisory Board may be re-elected and revoked by the Sole Shareholder.

The members of the Supervisory Board may be executive officers and members of the Supervisory Board 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 the Erste Group, the approval of the Supervisory Board is necessary for holding such position in the other business organization.

The Supervisory Board shall elect a Chairman from among its members, by simple majority and open voting.

The Chairman of the Supervisory Board may attend the meetings of the Board of Directors with the right of consultation.

The specific compensation of each member is calculated by dividing the annual allowance by twelve and multiplying the result by the number of months, served in the respective position during the year.

### 30) Securities lending and repurchase transactions

in HUF million	Carrying amount 2011	Fair value 2011	Carrying amount 2010	Fair value 2010	Carrying amount as at 1 January 2010	Fair value as at 1 January 2010
<b>Asset</b>	<b>3,774</b>	<b>3,567</b>	<b>12,443</b>	<b>12,366</b>	<b>1,912</b>	<b>1,872</b>
Reversed repurchase transactions	1,400	1,177	1,796	1,750	1,912	1,872
Securities borrowed	2,374	2,390	10,646	10,616	0	0
<b>Liabilities</b>	<b>25,004</b>	<b>23,918</b>	<b>10,758</b>	<b>10,760</b>	<b>11,561</b>	<b>11,664</b>
Repurchase transactions	25,004	23,918	10,758	10,760	11,561	11,664

in HUF million	2011	2010	As at 1 January 2010
Loans and advances to customers	3,774	12,443	1,912
Trading assets	2,329	9,047	9,929
Financial assets - held to maturity	22,675	1,711	1,632
<b>Total assets</b>	<b>28,777</b>	<b>23,201</b>	<b>13,473</b>
Deposits by banks	18,090	0	965
Customer deposits	5,829	10,760	10,698
<b>Total liabilities</b>	<b>23,918</b>	<b>10,760</b>	<b>11,664</b>

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

### 31) Risk management

#### 31.1. Risk policy and strategy

It is a core function of every bank to take risks in a conscious and selective manner and to professionally manage such risks. Erste Hungary's proactive risk policy and strategy aims at achieving harmony with Erste Group policies and a sustainable business proposition.

In addition to meeting the internal goal of effective and efficient risk management, Erste Hungary's control and risk management system has been developed to fulfil external, and in particular, regulatory requirements.

Given Erste Hungary's business strategy, the key risks for Erste Hungary 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 Erste Hungary.

#### 31.2. Risk management organisation

Risk monitoring and control is achieved through a clear organisational structure with defined roles and responsibilities, delegated authorities, 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 perform its oversight function within Erste Hungary's risk management structure. Risk control and management functions within Erste Hungary are performed based on the business and risk strategies approved by the Management Board and the strategic risk framework. 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 Management Board is supported by several divisions established to perform operative risk control functions and exercise strategic management responsibilities:

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

Strategic Risk Management, 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. This unit is comprised of the departments "OpRisk", "Risk Control" and "Rating and Risk Analysis".

Retail Risk Management focuses on retail business, which is Erste Hungary's primary business. Retail Risk 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 a dedicated department for underwriting of new loan acquisitions. Its collateral evaluation department is monitoring the collateral value of new acquisitions and performs regular collateral portfolio reviews. Collection and Work Out departments of the Directorate are responsible for early and hard collection activity regarding the retail portfolio.

Corporate Risk 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 Risk 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 corporates, and real estate risks. Corporate Risk 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 Risk 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 Risk Management area.

Corporate Workout and Restructuring is responsible for restructuring and workout of accounts in the corporate segment.

Legal, 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 has the focus on legal risk management and reporting aiming at identifying and minimizing, limiting or avoiding legal risk.

Compliance 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**

With the purpose of carrying out risk management activities within Erste Hungary, certain committees have been established, including the following:

- The Risk 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 infrastructure. The Risk 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 Committee is frequently and regularly briefed on the risk status, both retrospectively and prospectively, and across all risk types. The Risk Committee analyses the current status as well as any trends and makes management decisions at the highest level.

Erste Hungary has established committees that are specifically responsible for monitoring and managing the following risk categories:

- The 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".

- The 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.

- The 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 Strategic Risk Management Committee of Erste Group respectively. The CRO Board and the Strategic 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 Strategic 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.

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.

### **31.3. Risk Control**

#### **Overview of Risk Control Governance Structure**

One objective of Strategic Risk Management, a unit that is independent from the business units, is to ensure that all risks measured or taken are within the limits approved by the Managing Board.

Rating and Risk Analysis, which is a subunit of Strategic Risk Management, is responsible for the key tasks regarding Erste Hungary’s credit risk methods and rating models (with the cooperation of Competence Centres in the different subsidiaries of Erste Group) and also has the responsibility for delivering data to the data pool of Erste Group, and capital requirement as well as provision calculation. The Operational Risk Management department is responsible for the identification, measurement and monitoring of operational risks within Erste Hungary. The Risk Control department, which is also a sub-unit of Strategic Risk Management monitors and analyses the portfolio and prepares the credit risk reporting for Erste Hungary. This unit is also in charge of the essential elements of the risk management framework and Erste Hungary’s risk policy principles which ensure adequate guidance on all risk-related matters. Furthermore, this unit is responsible for the Internal Capital Adequacy Assessment Process (ICAAP), planning of risk and risk costs, risk-weighted asset management as well as stress testing and risk simulation. The daily calculation, analysis and reporting of market and liquidity risks is provided by the Market and Liquidity Risk Management department of Corporate Risk Management. Ongoing risk calculations are performed using models, the quality of which is continually refined by this department.

#### **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).

For the operational risk Erste Hungary received regulatory approval to use the AMA (Advanced Measurement Approach) in the first half of 2009. Beginning of October 2010, additionally Erste Leasing Autofinanszírozási Zrt., and its subsidiaries Erste Leasing Eszközfinanszírozási Zrt. and Erste Leasing Bérlet Szolgáltató Kft. received the approval to use AMA.

### 31.4. Risk and capital management

#### Overview

Erste Hungary's risk management framework is continuously evolving and improving, and not just as a reaction to the recent turbulence on the financial markets; in particular Strategic Risk Management has been developed into a comprehensive framework with ICAAP and enterprise-wide risk management concept as a principal driver, as required under Pillar 2 of the Basel framework.

The enterprise-wide risk management (ERM) framework is designed to support the Bank's management in managing risk 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, and 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

A major focus of the risk strategy of Erste Hungary is to prevent excessive risks which could compromise the achievement of strategic goals. Equally important is the Risk Limit Frame derived from the strategy of the Group and which consists of adequate top-down limits.

#### *Portfolio and Risk Analytics*

For the purpose of adequate management of the group's risk portfolios according to the strategy, risks are systematically analyzed 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.

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, at a national level (National Bank of Hungary). 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, currently the three main types of banking risks, credit risk, market risk and operational risk, are considered in the Risk-bearing Capital Calculation. Credit risk accounts for approximate 80% 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 these three 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 business 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.

In addition to the credit limits set by the existing limit frame of the Erste Group, Erste Hungary has defined a Maximum Risk Exposure Limit ("MREL") which, along with the signal system, serves to ensure that there is sufficient time (at least one year) for the management to plan and execute actions to ensure capital adequacy and sustainability going forward.

#### *Risk Planning and Forecasting*

It lies within responsibility of Strategic Risk Management to ensure a sound risk planning and forecasting process. The relevant risk planning numbers flow directly into the planning and steering process.

All insights from the ERM/ICAAP are taken into account in the process of allocating capital to entities and segments under risk/return considerations.

### **31.5. 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 Management. See 'Risk Management Organisation - Overview of Risk Management Structure' for a detailed explanation of the role and responsibilities of Corporate Risk Management.

The "Risk Control" department of Erste Hungary comprises of regular 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 'Erste Group Rating Methods'.

#### *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

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

### *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 payout 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.

### *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).

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 corporates 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 a 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 Management is responsible to undertake these monitoring activities and fulfil the minimum requirements of Erste Hungary Retail Risk Management.

## Credit Exposure

Credit exposure relates to the following items of statement of financial position:

- loans and advances to credit institutions
- loans and advances to customers

- debt securities held for trading, available for sale and held to maturity
- derivatives
- 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 Risk Exposure by Industry

## Credit exposure by industry 2011

in HUF million	Loans and advances to credit institutions	Loans and advances to customers	Held to maturity	Trading assets	Available for sale assets	Positive fair value of derivative financial instruments	Off balance sheet	Total credit risk exposure
	at amortised cost			Fair Value				
Agriculture and forestry	0	39,865	0	0	0	0	1,371	41,236
Construction	0	55,105	0	0	0	0	7,727	62,832
Education, health and art	0	6,372	0	0	0	0	553	6,926
Energy and water supply	0	52,586	1	0	0	0	7,358	59,945
Financial and insurance services	226,109	25,109	5,791	102,646	159,889	11,805	13,000	544,348
Hotels and restaurants	0	17,077	0	0	0	0	1,988	19,065
Manufacturing	0	81,615	0	2,708	0	0	16,121	100,443
Mining	0	773	0	0	0	0	577	1,350
Private households	0	1,422,240	0	0	0	0	14,380	1,436,619
Public administration	0	135,687	308,211	30,210	55	0	11,352	485,515
Real estate and housing	0	291,183	0	0	0	0	3,167	294,350
Services	0	26,062	0	0	0	0	1,512	27,575
Trade	0	88,084	0	0	0	9,665	5,056	102,804
Transport and communication	0	30,545	0	0	0	0	6,524	37,069
Other	0	37,449	0	2,268	0	158	7,829	47,704
<b>Total</b>	<b>226,109</b>	<b>2,309,752</b>	<b>314,002</b>	<b>137,832</b>	<b>159,944</b>	<b>21,628</b>	<b>98,514</b>	<b>3,267,782</b>

## Credit exposure by industry 2010

in HUF million	Loans and advances to credit institutions	Loans and advances to customers	Held to maturity	Trading assets	Available for sale assets	Positive fair value of derivative financial instruments	Off balance sheet	Total credit risk exposure
	at amortised cost			Fair Value				
Agriculture and forestry	0	35,301	0	0	0	0	4,838	40,138
Construction	0	58,893	0	0	0	0	15,495	74,388
Education, health and art	0	6,507	0	0	0	0	429	6,936
Energy and water supply	0	32,552	1	0	0	0	3,592	36,146
Financial and insurance services	119,112	10,877	7,453	120,621	30,058	10,505	16,451	315,077
Hotels and restaurants	0	17,682	0	0	0	0	1,689	19,371
Manufacturing	0	90,868	0	2,380	0	0	31,283	124,531
Mining	0	949	0	0	0	0	435	1,383
Private households	0	1,403,089	0	0	0	0	1,939	1,405,028
Public administration	0	110,020	312,666	38,748	1,049	0	1,786	464,269
Real estate and housing	0	284,038	0	0	0	0	16,550	300,587
Services	0	33,532	0	0	0	0	2,925	36,457
Trade	0	89,493	0	9,894	0	0	9,296	108,682
Transport and communication	0	65,375	0	0	0	0	7,885	73,260
Other	0	19,032	0	14,602	0	0	8,254	41,888
<b>Total</b>	<b>119,112</b>	<b>2,258,206</b>	<b>320,120</b>	<b>186,245</b>	<b>31,107</b>	<b>10,505</b>	<b>122,845</b>	<b>3,048,141</b>

## Credit exposure by industry as at 1 January 2010

in HUF million	Loans and advances to credit institutions	Loans and advances to customers	Held to maturity	Trading assets	Available for sale assets	Positive fair value of derivative financial instruments	Off balance sheet	Total credit risk exposure
	at amortised cost			Fair Value				
Agriculture and forestry	0	146,761	0	0	0	0	3,380	150,141
Construction	0	59,193	0	0	0	0	6,751	65,943
Education, health and art	0	122,378	0	0	0	0	1,341	123,719
Energy and water supply	0	32,062	1	0	0	0	2,718	34,780
Financial and insurance services	30,722	6,876	7,249	299,810	0	18,040	14,017	376,715
Hotels and restaurants	0	14,717	0	0	0	0	1,082	15,800
Manufacturing	0	99,096	0	1,971	0	0	13,577	114,644
Mining	0	493	0	0	0	0	401	895
Private households	0	977,216	0	0	0	0	14,174	991,390
Public administration	0	85,794	0	0	0	0	5,290	91,084
Real estate and housing	0	276,718	0	0	0	0	11,822	288,540
Services	0	32,424	0	0	0	0	3,778	36,202
Trade	0	101,746	0	10,169	0	0	11,076	122,991
Transport and communication	0	72,920	0	0	0	0	11,270	84,190
Other	0	45,512	285,856	44,657	1,092	0	4,859	381,977
<b>Total</b>	<b>30,722</b>	<b>2,073,907</b>	<b>293,106</b>	<b>356,608</b>	<b>1,092</b>	<b>18,040</b>	<b>105,536</b>	<b>2,879,011</b>

#### Credit Exposure by Risk Category

The following table presents the total credit risk exposure of Erste Hungary by risk category as of 31 December 2011 as compared with the total credit exposure as of 31 December 2010.

#### Credit exposure by risk category 2011

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Total exposure at 31 Dec 2011	2,103,464	524,510	163,381	476,427	3,267,782
Share of credit risk exposure	64.4%	16.1%	5.0%	14.6%	100.0%
Total exposure at 31 Dec 2010	2,127,388	467,421	185,096	268,236	3,048,140
Share of credit risk exposure	69.8%	15.3%	6.1%	8.8%	100.0%
Change in credit risk exposure in 2011	(23,924)	57,089	(21,715)	208,191	219,642
Change	(1.1)%	12.2%	(11.7)%	77.6%	7.2%

#### Credit exposure by risk category 2010

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Total exposure at 31 Dec 2010	2,127,388	467,421	185,096	268,236	3,048,140
Share of credit risk exposure	69.8%	15.3%	6.1%	8.8%	100.0%
Total exposure at 1 Jan 2010	2,267,953	304,372	133,101	173,586	2,879,012
Share of credit risk exposure	78.8%	10.6%	4.6%	6.0%	100.0%
Change in credit risk exposure in 2010	(140,565)	163,049	51,995	94,650	169,129
Change	(6.2)%	53.6%	39.1%	54.5%	5.9%

*Credit Exposure by Industry and Risk Category*

The following tables present the total credit risk exposure of Erste Hungary broken down by industry and risk category:

**Credit exposure by industry and risk category in 2011**

<b>in HUF million</b>	<b>Low risk</b>	<b>Management attention</b>	<b>Substandard</b>	<b>Non-performing</b>	<b>Total credit risk exposure</b>
Agriculture and forestry	22,726	11,736	595	6,180	41,236
Construction	32,969	8,933	4,360	16,571	62,833
Education, health and art	4,366	1,526	441	592	6,926
Energy and water supply	21,650	26,614	203	11,478	59,945
Financial and insurance services	535,653	2,932	247	5,516	544,348
Hotels and restaurants	7,734	7,054	611	3,667	19,065
Manufacturing	55,761	20,738	1,840	22,105	100,443
Mining	558	784	1	6	1,350
Private households	741,808	320,705	141,938	232,170	1,436,619
Public administration	444,072	35,273	18	6,152	485,515
Real estate and housing	126,146	42,581	8,007	117,616	294,350
Services	11,863	9,047	310	6,354	27,575
Trade	53,963	16,088	4,070	28,684	102,804
Transport and communication	19,908	8,346	733	8,082	37,069
Other	24,287	12,155	7	11,255	47,704
<b>Total</b>	<b>2,103,464</b>	<b>524,510</b>	<b>163,381</b>	<b>476,427</b>	<b>3,267,782</b>

**Credit exposure by industry and risk category in 2010**

<b>in HUF million</b>	<b>Low risk</b>	<b>Management attention</b>	<b>Substandard</b>	<b>Non-performing</b>	<b>Total credit risk exposure</b>
Agriculture and forestry	22,545	14,066	637	2,891	40,138
Construction	51,964	11,209	661	10,554	74,388
Education, health and art	4,834	1,920	28	153	6,936
Energy and water supply	22,121	5,941	536	7,548	36,146
Financial and insurance services	309,137	4,426	343	1,171	315,077
Hotels and restaurants	9,528	8,175	326	1,342	19,371
Manufacturing	65,930	30,589	15,614	12,398	124,531
Mining	963	57	0	363	1,383
Private households	903,849	197,211	146,111	157,858	1,405,028
Public administration	457,974	6,044	0	250	464,269
Real estate and housing	148,314	98,989	13,353	39,931	300,587
Services	22,341	9,825	1,979	2,312	36,457
Trade	52,603	27,015	4,513	24,551	108,682
Transport and communication	24,565	41,933	576	6,186	73,260
Other	30,721	10,022	418	727	41,888
<b>Total</b>	<b>2,127,388</b>	<b>467,421</b>	<b>185,096</b>	<b>268,236</b>	<b>3,048,140</b>

**Credit exposure by industry and risk category as at 1 January 2010**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Agriculture and forestry	111,857	22,313	11,069	4,903	150,141
Construction	55,981	4,913	113	4,937	65,943
Education, health and art	89,523	20,238	10,779	3,178	123,719
Energy and water supply	24,247	3,261	107	7,165	34,780
Financial and insurance services	374,458	2,193	15	50	376,715
Hotels and restaurants	13,203	506	62	2,029	15,800
Manufacturing	77,654	16,762	5,514	14,714	114,644
Mining	423	460	0	12	895
Private households	665,212	149,337	94,376	82,464	991,390
Public administration	84,679	6,402	0	2	91,084
Real estate and housing	232,326	34,636	483	21,094	288,540
Services	29,626	1,732	144	4,700	36,202
Trade	73,421	21,058	9,397	19,115	122,991
Transport and communication	63,026	13,699	665	6,800	84,190
Other	372,316	6,861	378	2,422	381,977
<b>Total</b>	<b>2,267,953</b>	<b>304,372</b>	<b>133,101</b>	<b>173,586</b>	<b>2,879,011</b>

**Credit exposure and non-performing loans (NPL) coverage by segment**

Local Retail contains in addition to 'Private household' the so called micro customers, up to 1.5 million euro GDP weighted turnover.

**Credit Exposure by business segment and risk category in 2011**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Local Retail	752,361	323,307	139,509	236,003	1,451,181
Local Corporates	324,391	155,897	13,826	131,489	625,603
Local Real Estate	104,107	38,867	9,457	105,714	258,144
Group Large Corporate	72,258	6,431	588	3,221	82,499
Group Markets	850,347	8	0	0	850,354
<b>Total</b>	<b>2,103,464</b>	<b>524,510</b>	<b>163,381</b>	<b>476,427</b>	<b>3,267,782</b>

**Credit Exposure by business segment and risk category in 2010**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Local Retail	909,067	199,818	147,216	161,199	1,417,301
Local Corporates	339,191	181,400	13,842	68,816	603,248
Local Real Estate	172,318	56,089	11,969	34,463	274,839
Group Large Corporate	50,663	30,107	12,068	3,758	96,596
Group Markets	656,150	7	0	0	656,157
<b>Total</b>	<b>2,127,388</b>	<b>467,421</b>	<b>185,096</b>	<b>268,236</b>	<b>3,048,140</b>

### Credit Exposure by business segment and risk category as at 1 January 2010

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Local Retail	680,249	154,708	96,503	84,822	1,016,282
Local Corporates	916,695	113,249	28,048	58,013	1,116,005
Local Real Estate	206,779	29,518	17	23,714	260,028
Group Large Corporate	79,732	6,898	8,533	7,036	102,199
Group Markets	384,498	0	0	0	384,498
<b>Total</b>	<b>2,267,953</b>	<b>304,372</b>	<b>133,101</b>	<b>173,586</b>	<b>2,879,012</b>

### Coverage of non-performing loans (NPL) by provisions 2011

Credit risk exposure					
in HUF million	Non-performing	Credit risk exposure	Risk provisions	NPL Ratio	NPL coverage
Local Retail	236,003	1,451,181	170,630	16.3%	72.3%
Local Corporates	131,489	625,603	93,955	21.0%	71.5%
Local Real Estate	105,714	258,144	67,390	41.0%	63.7%
Group Large Corporate	3,221	82,499	2,700	3.9%	83.8%
Group Markets	0	850,354	0	0.0%	
<b>Total</b>	<b>476,427</b>	<b>3,267,782</b>	<b>334,676</b>	<b>14.6%</b>	<b>70.2%</b>

Restructured loans within the performing portfolio amount to 163,419 million forint. The interest realised on the non-performing portfolio is 9,507 million forint.

### Coverage of non-performing loans (NPL) by provisions 2010

Credit risk exposure					
in HUF million	Non-performing	Credit risk exposure	Risk provisions	NPL Ratio	NPL coverage
Local Retail	161,199	1,417,301	81,122	11.4%	50.3%
Local Corporates	68,816	603,248	42,765	11.4%	62.1%
Local Real Estate	34,463	274,839	16,786	12.5%	48.7%
Group Large Corporate	3,758	96,596	3,478	3.9%	92.6%
Group Markets	0	656,157	0	0.0%	
<b>Total</b>	<b>268,236</b>	<b>3,048,140</b>	<b>144,152</b>	<b>8.8%</b>	<b>53.7%</b>

Restructured loans within the performing portfolio amount to 108,298 million forint. The interest realised on the non-performing portfolio is 4,541 million forint.

### Coverage of non-performing loans (NPL) by provisions as at 1 January 2010

Credit risk exposure					
in HUF million	Non-performing	Credit risk exposure	Risk provisions	NPL Ratio	NPL coverage
Local Retail	84,822	1,016,282	41,614	8.3%	49.1%
Local Corporates	58,013	1,116,005	24,919	5.2%	43.0%
Local Real Estate	23,714	260,028	8,596	9.1%	36.2%
Group Large Corporate	7,036	102,199	3,140	6.9%	44.6%
Group Markets	0	384,498	13	0.0%	
<b>Total</b>	<b>173,586</b>	<b>2,879,012</b>	<b>78,282</b>	<b>6.0%</b>	<b>45.1%</b>

Restructured loans within the performing portfolio amount to 56,145 million forint.

**Credit exposure and collateral in 2011**

in HUF million	Credit risk exposure	Basel II collaterals total	Collaterals and other credit risk mitigation		
			Guarantees	Real estate	Other
Central governments and central banks	636,779	705	704	1	0
Regional governments and local authorities	121,987	3,002	1,686	762	554
Administrative bodies and non-commercial undertakings	0	0	0	0	0
Multilateral development banks	54	0	0	0	0
International organisations	0	0	0	0	0
Institutions	270,354	14,820	0	12,213	2,607
Corporates	774,263	316,281	18,728	258,738	38,815
Retail & SME	1,461,435	929,412	1,542	840,586	87,284
Securitisation positions	0	0	0	0	0
Other	2,908	1,718	49	958	710
<b>Total</b>	<b>3,267,782</b>	<b>1,265,939</b>	<b>22,709</b>	<b>1,113,258</b>	<b>129,971</b>

**Credit exposure and collateral in 2010**

in HUF million	Credit risk exposure	Basel II collaterals total	Collaterals and other credit risk mitigation		
			Guarantees	Real estate	Other
Central governments and central banks	520,645	854	832	22	0
Regional governments and local authorities	116,264	3,616	1,662	1,418	536
Administrative bodies and non-commercial undertakings	0	0	0	0	0
Multilateral development banks	6,903	0	0	0	0
International organisations	0	0	0	0	0
Institutions	161,729	27,314	0	24,923	2,391
Corporates	788,066	362,556	39,494	285,582	37,481
Retail & SME	1,441,215	1,002,165	1,657	881,420	119,089
Securitisation positions	0	0	0	0	0
Other	13,319	9,384	4	959	8,422
<b>Total</b>	<b>3,048,140</b>	<b>1,405,890</b>	<b>43,649</b>	<b>1,194,323</b>	<b>167,918</b>

**Credit exposure and collateral as at 1 January 2010**

in HUF million	Credit risk exposure	Basel II collaterals total	Collaterals and other credit risk mitigation		
			Guarantees	Real estate	Other
Central governments and central banks	640,894	960	960	0	0
Regional governments and local authorities	102,532	383	5	37	342
Administrative bodies and non-commercial undertakings	0	0	0	0	0
Multilateral development banks	8,968	0	0	0	0
International organisations	0	0	0	0	0
Institutions	123,549	24,734	0	22,415	2,319
Corporates	691,700	338,211	47,130	244,082	47,000
Retail & SME	1,288,039	812,941	3,305	641,555	168,080
Securitisation positions	0	0	0	0	0
Other	23,330	13,129	6	616	12,506
<b>Total</b>	<b>2,879,012</b>	<b>1,190,358</b>	<b>51,406</b>	<b>908,705</b>	<b>230,247</b>

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 valuation of security takes into account the requirements for risk mitigation under Basel II.

The value of collateral is capped at the amount of exposure.

**Balances of assets past due, but not yet individually impaired**

	Credit risk exposure			thereof collateralised		
	Total loans and advances 90 days past due	thereof	thereof	Total loans and advances past due	thereof	thereof
		91-180 days past due	more than 180 days past due		91-180 days past due	more than 180 days past due
<b>2011</b>						
<b>in HUF million</b>						
Regional governments and local authorities	0	0	0	0	0	0
Institutions	0	0	0	0	0	0
Corporates	1,207	554	653	830	349	481
Retail & SME	1,086	663	423	402	289	113
<b>Total</b>	<b>2,293</b>	<b>1,218</b>	<b>1,075</b>	<b>1,232</b>	<b>638</b>	<b>594</b>

Loans and advances past due by 1 – 90 days amounts to 287,595 million forint.

	Credit risk exposure			thereof collateralised		
	Total loans and advances 90 days past due	thereof	thereof	Total loans and advances past due	thereof	thereof
		91-180 days past due	more than 180 days past due		91-180 days past due	more than 180 days past due
<b>2010</b>						
<b>in HUF million</b>						
Regional governments and local authorities	0	0	0	0	0	0
Institutions	0	0	0	0	0	0
Corporates	8,047	4,853	3,194	6,095	4,369	1,726
Retail & SME	6,240	4,543	1,698	3,470	2,560	910
<b>Total</b>	<b>14,287</b>	<b>9,395</b>	<b>4,892</b>	<b>9,565</b>	<b>6,929</b>	<b>2,636</b>

Loans and advances past due by 1 – 90 days amounts to 253,017 million forint.

	Credit risk exposure			thereof collateralised		
	Total loans and advances 90 days past due	thereof	thereof	Total loans and advances past due	thereof	thereof
		91-180 days past due	more than 180 days past due		91-180 days past due	more than 180 days past due
<b>As at 1 January 2010</b>						
<b>in HUF million</b>						
Regional governments and local authorities	0	0	0	0	0	0
Institutions	0	0	0	0	0	0
Corporates	4,953	1,909	3,043	3,934	1,296	2,638
Retail & SME	11,849	5,897	5,951	7,891	4,021	3,870
<b>Total</b>	<b>16,802</b>	<b>7,807</b>	<b>8,995</b>	<b>11,825</b>	<b>5,317</b>	<b>6,509</b>

**Loans and advances to customers by business segment 2011**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total loans	Risk provisions	NPL Ratio	NPL coverage
Local Retail	741,671	320,322	138,449	235,880	1,436,322	170,511	16.4%	72.3%
Local Corporates	278,624	149,092	13,540	130,157	571,411	93,726	22.8%	72.0%
Local Real Estate	92,656	38,349	9,397	105,577	245,978	67,221	42.9%	63.7%
Group Large Corporate	42,386	6,052	0	3,221	51,659	2,700	6.2%	83.8%
Group Markets	4,382	0	0	0	4,382	0	0.0%	
<b>Total</b>	<b>1,159,719</b>	<b>513,814</b>	<b>161,386</b>	<b>474,834</b>	<b>2,309,752</b>	<b>334,158</b>	<b>20.6%</b>	<b>70.4%</b>

**Loans and advances to customers by business segment 2010**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total loans	Risk provisions	NPL Ratio	NPL coverage
Local Retail	908,081	199,280	146,607	161,047	1,415,014	81,001	11.4%	50.3%
Local Corporates	292,979	158,251	13,290	68,409	532,929	42,175	12.8%	61.7%
Local Real Estate	137,921	55,244	11,969	34,413	239,547	16,616	14.4%	48.3%
Group Large Corporate	18,545	28,372	8,169	3,667	58,753	3,257	6.2%	88.8%
Group Markets	11,962	0	0	0	11,962	0	0.0%	
<b>Total</b>	<b>1,369,488</b>	<b>441,147</b>	<b>180,035</b>	<b>267,535</b>	<b>2,258,206</b>	<b>143,049</b>	<b>11.8%</b>	<b>53.5%</b>

**Loans and advances to customers by business segment as at 1 January 2010**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total loans	Risk provisions	NPL Ratio	NPL coverage
Local Retail	655,048	151,984	95,332	84,708	987,072	41,267	8.6%	48.7%
Local Corporates	612,105	90,151	27,560	57,585	787,401	24,088	7.3%	41.8%
Local Real Estate	171,967	26,969	17	23,189	222,142	8,559	10.4%	36.9%
Group Large Corporate	46,472	3,493	3,936	6,946	60,848	2,839	11.4%	40.9%
Group Markets	16,445	0	0	0	16,445	13	0.0%	
<b>Total</b>	<b>1,502,037</b>	<b>272,597</b>	<b>126,845</b>	<b>172,428</b>	<b>2,073,907</b>	<b>76,765</b>	<b>8.3%</b>	<b>44.5%</b>

**31.6. 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 concerns both, trading as well as banking book positions.

**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 Board. 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 bank 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 2011 and 31 December 2010 at a 99% confidence level, with a holding period of one day:

2011 in HUF million	Total	Interest	Currency	Price
Erste Hungary	3,594	3,581	98	56
Banking book	3,686	3,686	0	0
Trading book	396	386	98	56

2010 in HUF million	Total	Interest	Currency	Price
Erste Hungary	4,505	4,466	110	40
Banking book	4,460	4,460	0	0
Trading book	419	389	110	40

As at 1 January 2010 in HUF million	Total	Interest	Currency	Price
Erste Hungary	4,003	4,018	82	124
Banking book	3,898	3,898	0	0
Trading book	509	523	82	124

Due to correlations among various factors total amounts are not a straight summation of partial figures.

The method used is subject to limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

#### *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.

Only the open fixed-income positions that are not allocated to the trading book are presented. Positive values indicate fixed-income risks on the asset side, i.e., a surplus of asset items; negative values represent a surplus on the liability side.

#### **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 shows 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	2011	2010	As at 1 January 2010
EUR	(977)	(3,247)	(1,098)
CHF	(4,351)	10,531	13,828
USD	(83)	678	(1,518)
JPY	(9)	32	7
Other	(36)	(24)	(337)

*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 positions, but the hedge accounting was not applied in 2010 and 2011.

**31.7. 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.

Short- and long-term liquidity risks are respectively limited by a survival period analysis and traffic light system 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.

2011 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
On-Balance Liquidity GAP	(96,312)	(834,681)	21,305	937,033
Off-Balance Liquidity GAP	(5,097)	(12,839)	(14,862)	0
2010 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
On-Balance Liquidity GAP	(112,403)	(715,219)	(192,988)	1,064,613
Off-Balance Liquidity GAP	(7,100)	(29,144)	(19,248)	0
As at 1 January in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
On-Balance Liquidity GAP	105,577	(585,530)	(385,143)	876,667
Off-Balance Liquidity GAP	(5,018)	2,931	(9,571)	0

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 Group holds securities eligible at central banks to manage liquidity risk. Maturities of contractual (principal only), non-discounted cash flows of these financial assets as of 31 December 2011, 31 December 2010 and 1 January 2010 respectively are shown in the following table:

2011 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
Eligible securities	263,345	48,955	261,168	68,045
thereof eligible municipality bonds	0	0	0	39,111

2010				
in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
Eligible securities	157,897	67,259	230,149	120,763
thereof eligible municipality bonds	0	0	0	60,875
<b>As at 1 January 2010</b>				
in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
Eligible securities	323,943	102,315	161,583	43,725
thereof eligible municipality bonds	0	0	0	52,207

*Financial liabilities*

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

2011 in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
<b>Non-derivative liabilities</b>						
Deposits by banks	1,684,385	1,767,830	508,669	540,257	657,979	60,925
Customer deposits	1,201,878	1,174,585	256,263	633,725	172,342	112,255
Debt securities in issue	4,788	5,850	1,838	1,989	901	1,123
Subordinated liabilities	83,880	97,476	0	53,635	8,442	35,400
<b>Total</b>	<b>2,974,931</b>	<b>3,045,741</b>	<b>766,770</b>	<b>1,229,605</b>	<b>839,663</b>	<b>209,703</b>

2010 in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
<b>Non-derivative liabilities</b>						
Deposits by banks	1,519,656	1,599,868	183,807	490,291	867,295	58,476
Customer deposits	1,092,732	1,107,207	251,895	547,095	233,743	74,474
Debt securities in issue	25,877	30,593	7,336	16,500	5,007	1,751
Subordinated liabilities	75,317	92,567	0	2,637	55,280	34,650
<b>Total</b>	<b>2,713,581</b>	<b>2,830,235</b>	<b>443,038</b>	<b>1,056,523</b>	<b>1,161,324</b>	<b>169,350</b>

As at 1 January 2010 in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
<b>Non-derivative liabilities</b>						
Deposits by banks	1,339,571	1,424,997	109,755	298,853	906,416	109,972
Customer deposits	1,137,078	1,124,550	221,943	613,390	224,646	64,570
Debt securities in issue	31,864	20,533	1,028	6,562	12,129	813
Subordinated liabilities	73,161	94,822	0	2,378	56,273	36,170
<b>Total</b>	<b>2,581,673</b>	<b>2,664,902</b>	<b>332,727</b>	<b>921,184</b>	<b>1,199,465</b>	<b>211,526</b>

*Repricing gap*

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

2011 in HUF million	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing gap in EUR positions	(63,120)	111,397	12,906	(31,345)
Repricing gap in HUF positions	(48,920)	27,536	(23,732)	252,037
Repricing gap in CHF positions	(29,605)	27,185	(8,422)	8

2010 in HUF million	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing gap in EUR positions	106,104	(106,519)	41,503	4,047
Repricing gap in HUF positions	(190,818)	20,038	(23,730)	258,386
Repricing gap in CHF positions	(25,709)	(5,628)	1,867	271

As at 1 January 2010 in HUF million	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing gap in EUR positions	164,227	(127,859)	(10,977)	(7,036)
Repricing gap in HUF positions	(3,300)	(28,857)	(33,327)	195,418
Repricing gap in CHF positions	89,203	(105,302)	13,915	208

*Maturity of contractual cash flow of derivatives*

Derivatives are shown net.

2011 in HUF million	Total contractual cash-flows	< 1 month	1-12 months	1-5 years
HUF	(20,799)	(90,519)	42,202	27,518
EUR	329,589	124,487	173,242	31,860
CHF	(358,473)	(38,261)	(245,972)	(74,239)
USD	16,886	(803)	17,689	0

2010 in HUF million	Total contractual cash-flows	< 1 month	1-12 months	1-5 years
HUF	49,776	(133,031)	156,171	26,636
EUR	200,934	162,251	(4,832)	43,515
CHF	(324,876)	(43,612)	(192,065)	(89,199)
USD	18,673	7,292	11,582	(200)

As at 1 January 2010 in HUF million	Total contractual cash-flows	< 1 month	1-12 months	1-5 years
HUF	151,943	(128,905)	211,901	68,947
EUR	157,859	164,671	(93,482)	86,669
CHF	(316,659)	(55,032)	(96,852)	(164,976)
USD	(4,801)	14,247	(18,836)	(212)

**31.8. Operational risk****Definition and overview**

In line with Hungarian regulation (200/2007 government directive), Erste Hungary defines operational risk as 'the risk of loss resulting from inadequacy or failure of internal processes, people or systems, or from external events including 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 accordingly the standard methodology of Erste Group 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 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 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 Hungary also reviews certain key indicators periodically to ensure early detection of changes in risk potential that may lead to losses.

Erste Hungary uses a group-wide insurance programme, which, since its establishment in 2004, has reduced the cost of meeting Erste 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 a vehicle to share losses within the group and access the external market.

To further enforce the management of security risks, the functions IT Security and Physical Security Management have been combined in October 2011 to the new service unit "Security Management" which reports directly to the CRO.

The quantitative and qualitative methods used, together with the risk mitigation measures described above form the operational risk framework of Erste 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 Hungary.

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 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 New Basel 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/discrimination events, which involves at least one internal party.

#### *External fraud:*

Losses due to acts 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/discrimination events.

#### *Clients, products and business practices:*

Losses arising from an 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 or damage to physical assets from 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, from relations with trade counterparties and vendors.

### 32) Fair value of 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 and asset-backed 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.

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

2011	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 - available for sale	0	160,814	0	160,814
Trading assets - securities	3,458	138,178	0	141,636
Positive market value - derivatives	0	21,628	0	21,628
<b>Total assets</b>	<b>3,458</b>	<b>320,620</b>	<b>0</b>	<b>324,078</b>
Negative market value - derivatives	0	48,973	0	48,973
Other trading liabilities	0	13	0	13
<b>Total liabilities and equity</b>	<b>0</b>	<b>48,986</b>	<b>0</b>	<b>48,986</b>

2010	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 - available for sale	0	31,978	0	31,978
Trading assets - securities	2,764	186,126	0	188,890
Positive market value - derivatives	0	10,505	0	10,505
<b>Total assets</b>	<b>2,764</b>	<b>228,609</b>	<b>0</b>	<b>231,373</b>
Negative market value - derivatives	0	54,508	0	54,508
Other trading liabilities	0	7,708	0	7,708
<b>Total liabilities and equity</b>	<b>0</b>	<b>62,216</b>	<b>0</b>	<b>62,216</b>

As at 1 January 2010	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 - available for sale		1,963		1,963
Trading assets - securities	1,116	356,756		357,872
Positive market value - derivatives		18,040		18,040
<b>Total assets</b>	<b>1,116</b>	<b>376,759</b>	<b>0</b>	<b>377,875</b>
Negative market value - derivatives		29,611		29,611
Other trading liabilities		12,731		12,731
<b>Total liabilities and equity</b>	<b>0</b>	<b>42,342</b>	<b>0</b>	<b>42,342</b>

The volume of products whose fair values are determined using valuation models based on observable market data is driven in large part by illiquid bonds and securities not quoted in an active market.

Level 2 category also contains listed government securities but as the transactions related to these securities, both in numbers and frequency, do not form an active market, the transaction prices cannot be taken as a reliable fair value.

#### *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:

in HUF million	2011		2010	
	Fair value	Carrying amount	Fair value	Carrying amount
<b>ASSETS</b>				
Cash and balances with central banks	328,162	328,162	111,594	111,594
Loans and advances to credit institutions	226,109	226,109	119,112	119,112
Loans and advances to customers	1,975,619	1,975,594	2,115,213	2,115,157
Financial assets - held to maturity	306,345	314,002	311,306	320,120
<b>LIABILITIES</b>				
Deposits by banks	1,684,385	1,684,385	1,519,656	1,519,656
Customer deposits	1,202,679	1,201,878	1,093,467	1,092,732
Debt securities in issue	4,633	4,788	24,382	25,877
Subordinated liabilities	83,715	83,880	75,071	75,317

'Loans and advances' are shown net of risk provisions.

### 33) Financial instruments per category according to IAS 39

2011 in HUF million	Loans and receivables	Held to maturity	Trading	Available for sale	Financial assets and financial liabilities at amortised cost	Total
<b>ASSETS</b>						
Cash and balances with central banks					328,162	328,162
Loans and advances to credit institutions	226,109					226,109
Loans and advances to customers	2,309,752					2,309,752
Risk provisions for loans and advances	(334,158)					(334,158)
Derivative financial instruments			21,628			21,628
Trading assets			141,635			141,635
Financial assets - available for sale				160,814		160,814
Financial assets - held to maturity		314,002				314,002
<b>Total financial assets</b>	<b>2,201,703</b>	<b>314,002</b>	<b>163,263</b>	<b>160,814</b>	<b>328,162</b>	<b>3,167,944</b>
<b>LIABILITIES</b>						
Deposits by banks					1,684,385	1,684,385
Customer deposits					1,201,878	1,201,878
Debt securities in issue					4,788	4,788
Derivative financial instruments			48,973			48,973
Trading liabilities			13			13
Subordinated liabilities					83,880	83,880
<b>Total financial liabilities</b>	<b>0</b>	<b>0</b>	<b>48,986</b>	<b>0</b>	<b>2,974,931</b>	<b>3,023,917</b>

2010 in HUF million	Loans and receivables	Held to maturity	Trading	Available for sale	Financial assets and financial liabilities at amortised cost	Total
<b>ASSETS</b>						
Cash and balances with central banks					111,594	111,594
Loans and advances to credit institutions	119,112					119,112
Loans and advances to customers	2,258,206					2,258,206
Risk provisions for loans and advances	(143,049)					(143,049)
Derivative financial instruments			10,505			10,505
Trading assets			188,890			188,890
Financial assets - available for sale				31,978		31,978
Financial assets - held to maturity		320,120				320,120
<b>Total</b>	<b>2,234,269</b>	<b>320,120</b>	<b>199,395</b>	<b>31,978</b>	<b>111,594</b>	<b>2,897,356</b>
<b>LIABILITIES</b>						
Deposits by banks					1,519,656	1,519,656
Customer deposits					1,092,732	1,092,732
Debt securities in issue					25,877	25,877
Derivative financial instruments			54,508			54,508
Trading liabilities			7,708			7,708
Subordinated liabilities					75,317	75,317
<b>Total</b>	<b>0</b>	<b>0</b>	<b>62,216</b>	<b>0</b>	<b>2,713,582</b>	<b>2,775,798</b>

As at 1 January 2010 in HUF million	Loans and receivables	Held to maturity	Trading	Available for sale	Financial assets and financial liabilities at amortised cost	Total
<b>ASSETS</b>						
Cash and balances with central banks					71,392	71,392
Loans and advances to credit institutions	30,722					30,722
Loans and advances to customers	2,073,907					2,073,907
Risk provisions for loans and advances	(76,765)					(76,765)
Derivative financial instruments			18,040			18,040
Trading assets			357,872			357,872
Financial assets - available for sale				1,963		1,963
Financial assets - held to maturity		293,106				293,106
<b>Total</b>	<b>2,027,864</b>	<b>293,106</b>	<b>375,912</b>	<b>1,963</b>	<b>71,392</b>	<b>2,770,237</b>
<b>LIABILITIES</b>						
Deposits by banks					1,339,571	1,339,571
Customer deposits					1,137,078	1,137,078
Debt securities in issue					31,864	31,864
Derivative financial instruments			29,611			29,611
Trading liabilities			12,731			12,731
Subordinated liabilities					73,161	73,161
<b>Total</b>	<b>0</b>	<b>0</b>	<b>42,342</b>	<b>0</b>	<b>2,581,674</b>	<b>2,624,016</b>

### 34) Audit fees and tax consultancy fees

The following table contains audit and tax fees charged by the auditors (Ernst & Young) in the fiscal years 2011 and 2010:

in HUF million	2011	2010
	229	208

### 35) 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 (see Note 32 credit exposure).

in HUF million	2011	2010	As at 1 January 2010
Guarantees	39,517	35,533	32,601
Committed credit lines -irrevocable	58,997	87,313	72,935
<b>Irrevocable contingent liabilities</b>	<b>98,514</b>	<b>122,845</b>	<b>105,536</b>
Committed credit lines - revocable	55,518	56,160	76,117
Legal cases	11,318	11,489	13,509
Other	15,470	1,412	1,851
<b>Total</b>	<b>180,820</b>	<b>191,907</b>	<b>197,013</b>

#### 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.

### 36) Analysis of remaining maturities

The breakdown of remaining maturities of the Bank's financial assets and liabilities and contingent liabilities based on contractual cash flows was as follows:

in HUF million	2011		2010		As at 1 January 2010	
	< 1 year	> 1 year	< 1 year	> 1 year	< 1 year	> 1 year
Cash and balances with central banks	328,162	0	111,594	0	71,392	0
Loans and advances to credit institutions	140,565	85,544	35,449	83,664	27,052	3,670
Loans and advances to customers	366,618	1,943,134	316,494	1,941,712	371,156	1,702,751
Risk provisions for loans and advances	(53,040)	(281,118)	(20,049)	(123,000)	(13,738)	(63,027)
Trading assets	134,404	7,231	183,049	5,842	348,485	9,388
Financial assets - available for sale	160,760	55	31,916	61	19	1,944
Financial assets - held to maturity	28,925	285,077	26,819	293,302	94,442	198,664
Intangible assets	0	11,765	0	11,034	0	10,595
Property and equipment	0	11,989	0	12,944	0	12,842
Current tax assets	1,451	0	2,273	0	2,327	0
Deferred tax assets	58	0	758	0	2,019	0
Assets classified as held for sale	1,564	0	2,124	0	2,850	0
Other assets	53,162	0	27,062	0	17,679	0
<b>Total</b>	<b>1,162,630</b>	<b>2,063,677</b>	<b>717,489</b>	<b>2,225,558</b>	<b>923,683</b>	<b>1,876,826</b>
Deposits by banks	1,066,570	617,814	627,605	892,051	423,797	915,774
Customer deposits	924,779	277,099	857,287	235,445	927,307	209,770
Debt securities in issue	4,667	120	21,070	4,807	7,508	24,356
Trading liabilities	13	0	7,708	0	12,731	0
Provisions	9,405	0	4,873	0	3,787	0
Current tax liabilities	182	0	161	0	36	0
Deferred tax liabilities	366	0	634	0	2,144	0
Other liabilities	36,276	0	24,908	0	25,463	0
Subordinated liabilities	51,365	32,515	865	74,452	864	72,297
Total equity	0	177,791	0	147,179	0	163,105
attributable to						
non-controlling interests	0	0	0	(32)	0	26
owners of the parent	0	177,791	0	147,211	0	163,080
<b>Total</b>	<b>2,093,624</b>	<b>1,105,339</b>	<b>1,545,111</b>	<b>1,353,933</b>	<b>1,403,637</b>	<b>1,385,302</b>

### 37) 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, return capital to shareholders. No changes have been made to the objectives, policies and processes from the previous years. The calculation is made by Hungarian regulatory requirements, based on the local Hungarian GAAP financial statements.

in HUF million	2011	2010	As at 1 January 2010
Tier 1 capital before deductions	190,255	138,953	132,954
Deductions from the Tier 1 capital (-)	(898)	(50)	(4,520)
<b>Tier 1 capital after deductions</b>	<b>189,357</b>	<b>138,904</b>	<b>128,434</b>
Tier 2 capital	50,610	50,425	56,335
Deductions from the Tier 2 capital (-)	(898)	(50)	(4,520)
<b>Total qualifying own funds</b>	<b>239,069</b>	<b>189,279</b>	<b>180,249</b>
Risk weighted assets (base for credit risk)	1,176,438	1,310,338	1,349,325
<b>Capital requirement for credit risk</b>	<b>94,115</b>	<b>104,827</b>	<b>107,946</b>
thereof IRB approach	76,350	87,670	87,379
thereof standardized approach	17,765	17,157	20,567
<b>Capital requirement for market risk</b>	<b>722</b>	<b>1,084</b>	<b>2,033</b>
thereof calculated with simple approach	722	1,084	2,033
thereof from debt instruments	660	700	1,144
thereof from capital instruments	47	47	186
thereof open fx-positions	2	337	703
thereof commodity risk	13	0	0
<b>Pillar 2 requirement (only the Bank)</b>	<b>2,134</b>	<b>131</b>	<b>417</b>
<b>Capital requirement for operational risk</b>	<b>16,453</b>	<b>18,300</b>	<b>20,246</b>
<b>Total base for capital requirement</b>	<b>1,391,125</b>	<b>1,552,638</b>	<b>1,627,813</b>
<b>Total capital requirement</b>	<b>111,290</b>	<b>124,211</b>	<b>130,225</b>
<b>Tier 1 ratio</b>	<b>13.6%</b>	<b>8.9%</b>	<b>7.9%</b>
<b>Solvency ratio</b>	<b>17.2%</b>	<b>12.2%</b>	<b>11.1%</b>
<b>Solvency ratio after pillar 2 deduction</b>	<b>16.9%</b>	<b>12.2%</b>	<b>11.0%</b>
<b>Legal minimum solvency ratio set by HFSA for Erste Hungary</b>	<b>10.7%</b>	<b>8.9%</b>	<b>8.9%</b>

**38) Events after the balance sheet date**

Erste Kereskedőház Kft. was merged into Erste Ingatlan Kft. at the date of 31 December 2011. From 1 January 2012 Erste Ingatlan Kft. continues its activity as legal successor of Erste Kereskedőház Kft. Given that the merger was conducted between entities under common control there is no financial impact of the transaction.

Erste Pénztárszervező Kft. is under voluntary liquidation. The company stopped its business activity in 2011, therefore there is no significant impact from this event is expected.

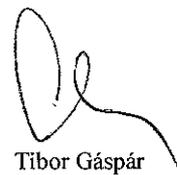
**39) Details of the companies wholly or partly-owned by Erste Bank Hungary Zrt. at 31 December 2011**

Company name	Interest of Erste Bank Hungary in % - directly or indirectly at 31.12.2011	Interest of Erste Bank Hungary in % - directly or indirectly at 31.12.2010	Interest of Erste Bank Hungary in % - directly or indirectly at 01.01.2010
<b>Subsidiaries:</b>			
Erste Befektetési Zrt.	100%	100%	100%
Portfolió Szolgáltató Kft.	100%	100%	100%
Erste Leasing Autófinanszírozási Zrt.	100%	98.04%	98.04%
Erste Leasing Eszközfinanszírozási Zrt.	100%	98.04%	98.04%
Erste Leasing Bérlet Szolgáltató Kft.	100%	98.04%	98.04%
Erste Ingatlanlízing Zrt.	100%	100%	100%
Erste Lakáslízing Zrt.	100%	100%	100%
Erste Ingatlan Kft.	100%	100%	100%
Erste Faktor Zrt.	100%	100%	100%
Erste Pénztárszervező Kft.	100%	100%	100%
Erste Kereskedőház Kft.	100%	100%	100%
Erste-Dat Kft.	-	100%	100%
Sió Ingatlan Invest Kft.	100%	100%	-
Erste Lakás-takarékpénztár Zrt.	100%	-	-
Magyar Factor Zrt.	100%	-	-
<b>Other investments:</b>			
Erste Vienna Insurance Group Zrt.	5%	5%	5%
Garantiqa Hiteagarancia Zrt.	3.5%	3.5%	3.5%
GIRO Zrt.	8.3%	8.3%	8.3%
Kisvállalkozás-fejlesztési Pénzügyi Zrt.	1.1%	1.1%	1.1%
Erste Group Immorent Kft.	9%	9%	9%
Erste Group Immorent Hungary Lizing Zrt.	9%	9%	9%
MasterCard Incorporated (USD)	0,018%	0,018%	0,018%
VISA Europe Limited (EUR)	0,0067%	0,0067%	0,0067%
VISA Incorporated (USD)	0,0015%	0,0015%	0,0015%

Date: Budapest, 24 April 2012



Radován Jelasity  
President and CEO



Tibor Gáspár  
Director of Finance and Accounting

## Independent auditors' report

To the shareholder of Erste Bank Hungary Zrt.

We have audited the accompanying 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 2011, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the consolidated Financial Statements

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

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Erste Bank Hungary Zrt. as of 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.



Ernst & Young Kft.  
Budapest, Hungary  
24 April 2012

