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 2017
with the Independent Auditors' Report

ERSTE BANK HUNGARY ZRT.

AUDITOR'S REPORT AND CONSOLIDATED FINANCIAL STATEMENTS IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS AS ADOPTED BY THE EUROPEAN UNION

31 DECEMBER 2017

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Erste Bank Hungary Zrt.

Report on the audit of the consolidated financial statements

Opinion

We have audited the accompanying consolidated financial statements of Erste Bank Hungary Zrt. (the "Bank") and its subsidiaries (together the "Group") which comprise the consolidated statement of financial position as of 31 December 2017 (in which the consolidated balance sheet total is MHUF 2,219,069), the consolidated income statement, the consolidated statement of comprehensive income (in which the total comprehensive income for the year is MHUF 58,262 profit), the consolidated statement of changes in equity, the consolidated cash flows statement for the year then ended and the notes to the consolidated financial statements including a summary of the significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union (EU) and they have been prepared, in all material respects, in accordance with the supplementary requirements of Act C of 2000 on Accounting ("Accounting Act") relevant for the consolidated annual financial statements prepared in accordance with IFRS as adopted by the EU.

Our opinion is consistent with our additional report to the audit committee.

Basis for opinion

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

We are independent of the Group in accordance with the applicable laws of Hungary, with the Hungarian Chamber of Auditors' Rules on ethics and professional conduct of auditors and on disciplinary process and, for matters not regulated in the Rules, with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board (IESBA Code of Ethics) and we also comply with further ethical requirements set out in these documents.

The non-audit services that we have provided to the Group, in the period from 1 January 2017 to 31 December 2017, are disclosed in note 38 to the financial statements.

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To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable laws and regulations in Hungary and that we have not provided non-audit services that are prohibited under Article 5 of the Regulation of the European Parliament and of the Council (the EU Regulation) No 537/2014 and the Subsections (1) and (2) of Section 67/A of Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors.

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

Our audit approach

Overview

Overall group materiality	Overall group materiality applied was MHUF 3,002
Group Scoping	We included four subsidiaries in our audit, which together with the parent company represent more than 95% of the consolidated balance sheet total and the consolidated net result.
Key Audit Matters	• Valuation of loans and receivables to customers • Accounting for the acquisition of Citibank's retail business

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

Materiality	MHUF 3,002
Determination	5% of the consolidated profit before tax
Rationale for the materiality benchmark applied	We chose consolidated profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most commonly measured by users and other stakeholders, and it is a generally accepted benchmark. We chose 5%, which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector.

Group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

We have identified four subsidiaries, which, in our view, required an audit of their significant account balances, due to their financial significance or level of risk for the Group. Those reporting components are public interest entities or perform significant supporting activity for the Group.

For the remaining components, we performed an analytical review on the Group level. This together with additional procedures performed on the Group level, including testing of consolidation journals and intercompany eliminations, gave us the evidence we needed for our opinion on the Group financial statements as a whole.

2017 was the first year we were appointed as auditors of the Bank. We commenced our preparation for the audit take-over already in 2016. Since our appointment in April 2017, we used the opportunity to meet with key members of the management and other employees of the Bank in order to obtain understanding of current business matters and to gather information that would enable us to plan our audit. We also held hand-over meeting with the prior year auditors and reviewed their working papers in order to understand on which controls they relied and what evidence they used to support their opinion.

Key audit matters

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

Key audit matter	***How our audit addressed the key audit matter***
Valuation of loans and receivables to customers The net amount of loans and receivables to customers was MHUF 1,123,697 as at 31 December 2017, representing 51% of the balance sheet total. Impairment recognised in the balance sheet amounted to MHUF 58,300. The management disclosed the related assumptions, balances and estimates in section D of the notes to the financial statements on accounting policy, as well as in notes 8., 18., and 35. Impairment is determined on the basis of subjective criteria and management is required to apply significant judgement when calculating individual and collective impairment.	We gained an understanding of the lending process from disbursement to monitoring and to the calculation of impairment, identified the main control points, and tested their operational effectiveness, including management's approval. We performed credit review for individually significant loans, and checked credit application / monitoring documents as well as customer-related financial and non-financial information whether the customer's rating is appropriate. For a sample of individually impaired loans, we checked whether assumptions and estimations applied in calculations of the recoverable amount are reasonable and whether the calculations are correct.

In the calculation of individual impairment, the most significant uncertainty is involved in the estimation of the amounts and timing of the expected future cash flows as they include recoveries from both collections of contractual cash flows and from collaterals.

The Bank applies impairment models to calculate collective impairment. These models quantify the probability of default and the loss given default as the primary parameters in the estimation of the recoverable amount.

We paid considerable attention to this area during our audit due to the significance of the amounts involved and also because of the nature of the judgments and assumptions that management is required to make.

When assessing collective impairment, we analysed the development of impairment with the assistance of our experts, checked the methodology applied to its calculation, the input data, changes of parameters, reconciled the estimations from previous periods with the actual data, and performed recalculations on a sample basis.

We read points 8, 18 and 35 of the notes to the financial statements to assess whether disclosures are in line with applicable regulations.

We did not identify any material errors during our audit procedures performed. We found management's estimations reasonable.

Accounting for the acquisition of Citibank's retail business

The Bank acquired Citibank's retail business in 2017. The transaction has been accounted for as a business combination in accordance with the requirements of IFRS 3 'Business Combinations', the relevant details of the transactions were presented in section B of the notes to the financial statements.

The business was acquired partly by Erste Bank Hungary Zrt., partly by Erste Befektetési Zrt. The Bank's gain from a bargain purchase is HUF 211 million, intangible assets identified in the course of the purchase price allocation amounted to HUF 7,894 million.

We paid particular attention to this matter because the acquired retail portfolio is significant, and it is an individual transaction, that requires complex accounting and significant management estimates. Furthermore, determining the fair value of the customer relationships identified among intangible assets depends on management's assumptions concerning future results and the interest rate used to discount future cash flows.

We have read the acquisition agreement read the accounting documents related to acquisition, and checked the accounting treatment of acquisition.

As part of our procedures, we have critically assessed whether assumptions used in the purchase price allocation performed by management with the aim of determining the fair value of the customer relationships are reasonable by performing the following:

- We have critically checked the report prepared on valuation, challenged the assumptions contained therein by involving our valuation expert.
- We focused our attention on examining whether estimated discount rate and the factors identified to forecast future cash flows (like expected client churn rates) are substantiated. In doing so, we compared the estimates to observable actual data concerning the volume and profitability of the transferred portfolios subsequent to the acquisition.

We have not detected any material errors as a result of our procedures performed.

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Other information: the consolidated business report

Other information comprises the consolidated business report of the Group. Management is responsible for the preparation of the consolidated business report in accordance with the provisions of the Accounting Act and other relevant regulations. Our opinion on the consolidated financial statements expressed in the "Opinion" section of our independent auditor's report does not cover the consolidated business report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the consolidated business report and, in doing so, consider whether the consolidated business report is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If based on our work performed we conclude that the consolidated business report is materially misstated we are required to report this fact and the nature of the misstatement.

Based on the Accounting Act, it is also our responsibility, when reading the consolidated business report to consider, whether it has been prepared in accordance with the provisions of the Accounting Act and other relevant regulations, if any, and to express an opinion on this and on whether the consolidated business report is consistent with the consolidated financial statements.

Because the Company's transferable securities are admitted to trading on a regulated market of a Member State of the European Economic Area, our opinion on the consolidated business report shall cover the information prepared under Paragraphs e) of Subsection (2) of Section 95/B, and state whether the information referred to in Paragraphs a)-d), g) and h) of Subsection (2) of Section 95/B of the Accounting Act has been provided.

As the Bank is a public interest entity preparing consolidated financial statements and the conditions in Paragraph a) and b) of Subsection (5) of Section 134 of the Accounting Act are met at the balance sheet date, the Bank shall publish a non-financial statement required by Section 95/C in its consolidated business report relating to the companies included in the consolidation. In this respect, we shall state whether the consolidated business report includes the non-financial statement required by Section 95/C, and Subsection (5) of Section 134 of the Accounting Act.

In our opinion, the 2017 consolidated business report of the Group, also including the information prepared under Paragraphs e) of Subsection (2) of Section 95/B, is consistent with the 2017 consolidated financial statements in all material respects, and the consolidated business report has been prepared in accordance with the provisions of the Accounting Act. As there is no other regulation prescribing further requirements for the consolidated business report, we do not express an opinion in this respect.

We are not aware of any other material inconsistency or material misstatement in the consolidated business report.

We state that the information referred to in Paragraphs a)-d), g) and h) of Subsection (2) of Section 95/B of the Accounting Act has been provided. The consolidated business report includes the non-financial statement required by Section 95/C, and Subsection (5) of Section 134 of the Accounting Act.

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

Management is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and to prepare the consolidated financial statements in accordance with the supplementary requirements of the Accounting Act relevant for the consolidated annual financial statements prepared in accordance with IFRS as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditor's responsibilities for the audit of the consolidated financial statements

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

As part of an audit in accordance with HNSAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting in the consolidated financial statements and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that gives a true and fair view.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

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

Report on other legal and regulatory requirements

We were first appointed as auditors of the Bank on 25 April 2017.

The engagement partner on the audit resulting in this independent auditor's report is Árpád Balázs.

Budapest, 13 April 2018

Árpád Balázs
Partner
Statutory auditor
Licence number: 006931
PricewaterhouseCoopers Könyvvizsgáló Kft.
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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 2017

Consolidated Financial Statements

Consolidated Financial Statements 2017 (IFRS)

I. Consolidated Income Statement for the year ended 31 December 2017

in HUF million	Notes	2016	2017
Interest income	1	72,202	74,812
Interest expense	1	(15,406)	(9,340)
Net interest income		**56,796**	**65,472**
Commission income	2	54,501	65,184
Commission expense	2	(10,340)	(16,501)
Net fee and commission income		**44,161**	**48,683**
Dividend income	3	28	81
Net trading and fair value result	4	6,738	10,865
Foreign exchange transactions	4	(539)	11,655
Other	4	7,277	(790)
Rental income from investment properties & other operating leases	5	1,236	1,180
Personnel expenses	6	(28,501)	(31,243)
Other administrative expenses	6	(26,064)	(27,516)
Depreciation and amortisation	6	(6,340)	(9,509)
Gains/(losses) from financial assets and liabilities not measured at fair value through profit or loss, net		2,890	5,753
Net impairment release/(loss) on financial assets not measured at fair value through profit or loss	8	(5,297)	2,804
Other operating result	9	1,772	(6,535)
Other operating income	9	40,168	38,523
Other operating expenses	9	(38,396)	(45,058)
Pre-tax result from continuing operations		**47,420**	**60,034**
Taxes on income	10	(4,077)	(5,280)
Net result for the period		**43,343**	**54,754**
Net result attributable to owners of the parent		**43,343**	**54,754**

II. Consolidated Statement of Comprehensive Income for the year ended 31 December 2017

in HUF million	2016	2017
Net result for the year	43,343	54,754
Items that may be reclassified to profit or loss		
Available for sale reserve (including currency translation)	(1,928)	3,586
Gain/loss during the year	(1,928)	3,586
Reclassification adjustments	0	0
Cash flow hedge reserve (including currency translation)	740	221
Gain/loss during the year	0	0
Reclassification adjustments	740	221
Deferred taxes relating to items that may be reclassified	618	(299)
Gain/loss during the year	618	(299)
Reclassification adjustments	0	0
Total other comprehensive income	**(570)**	**3,508**
Total comprehensive income	**42,773**	**58,262**
Total comprehensive income attributable to owners of the parent	**42,773**	**58,262**

Date: Budapest, 13 April 2018

Radován Jelasity
Chairman and CEO

Ivan Vondra
Chief Financial Officer

III. Consolidated Statement of Financial Position at 31 December 2017

in HUF million	Notes	2016	2017
Assets			
Cash and cash balances with central bank	11	106,050	21,324
Financial assets - held for trading		133,055	143,705
Derivatives	12	15,397	21,083
Other trading assets	13	117,658	122,622
thereof pledged as collateral	32	2,489	1,682
Financial assets - available for sale	14	137,749	136,765
thereof pledged as collateral	32	36,247	15,094
Financial assets - held to maturity	15	436,668	651,900
thereof pledged as collateral	32	61,659	51,949
Loans and receivables to credit institutions	17	145,499	68,672
thereof pledged as collateral	32	1,278	4,085
Loans and receivables to customers	18	1,021,232	1,123,697
thereof pledged as collateral	32	98,168	274,568
Property and equipment	19	8,991	8,600
Investment properties	19	10,620	10,347
Intangible assets	19	18,310	25,565
Current tax assets	20	1,000	704
Deferred tax assets	20	33	-
Assets held for sale	21	187	1
Other assets	22	27,486	27,791
Total assets		**2,046,881**	**2,219,069**
Liabilities and equity			
Financial liabilities - held for trading		12,398	15,162
Derivatives	12	11,337	15,092
Other trading liabilities	23	1,060	70
Financial liabilities designated at fair value through profit or loss		24,481	37,584
Debt securities issued	24	24,481	37,584
Financial liabilities measured at amortised cost		1,671,155	1,787,542
Deposits from banks	24	213,655	202,560
Deposits from customers	24	1,419,097	1,540,898
Debt securities issued	24	38,403	44,083
Provisions	25	25,156	8,691
Current tax liabilities	20	9	-
Deferred tax liabilities	20	238	584
Other liabilities	26	32,429	30,228
Total equity	27	281,015	339,278
Equity attributable to owners of the parent		281,015	339,278
Total liabilities and equity		**2,046,881**	**2,219,069**

Date: Budapest, 13 April 2018

Radován Jelasity
Chairman and CEO

Ivan Vondra
Chief Financial Officer

IV. Consolidated Statement of Changes in Total Equity

Statement of changes in total equity for the year ended 31 December 2017

in HUF million	Notes	Subscribed capital	Additional paid-in capital	Retained earnings	Available for sale reserve	Cash flow hedge reserve	Deferred tax related to 'Available for sale reserve'	Deferred tax related to 'Cash flow hedge reserve'	Attributable to owners of the parent	Total equity 2017
Total equity at 01 January 2017	27	**146,000**	**117,492**	**15,156**	**2,844**	**(221)**	**(256)**	**-**	**281,015**	**281,015**
Dividends		-	-	-	-	-	-	-	-	-
Capital increases		-	-	-	-	-	-	-	-	-
Transfer		-	-	-	-	-	-	-	-	-
Total comprehensive income		-	-	54,754	3,586	221	(299)	-	58,262	**58,262**
of which: Net profit / (loss) for the year		-	-	54,754	-	-		-	54,754	**54,754**
of which: Other comprehensive income		-	-	-	3,586	221	(299)	-	3,509	**3,509**
Total equity at 31 December 2017	27	**146,000**	**117,492**	**69,910**	**6,430**	**-**	**(555)**	**-**	**339,278**	**339,278**

1) Details see in Note 27) Total equity, section Subscribed capital and additional paid-in capital, page 48.
2) All items are to reclassify subsequently into profit and loss, in both year.

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

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

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V. Consolidated Statement of Cash Flows

in HUF million	2016	2017
Net result for the period	**43,343**	**54,754**
Non-cash adjustments for items in net profit/loss for the year	-	-
Depreciation, amortisation, impairment and reversal of impairment, revaluation of assets	7,935	10,317
Allocation to and release of provisions (including risk provisions) and provision for FX settlement	(143,078)	(36,820)
Gains/(losses) from the sale of assets	3,677	(4,284)
Revaluation of subordinated liabilities	214	(144)
FX settlement effect - exposure decrease for existing loans	-	-
Revaluation of derivatives	(13,578)	(1,939)
Other adjustments	193	601
Changes in assets and liabilities from operating activities after adjustment for non-cash components	-	-
Financial assets - held for trading	(59,714)	(4,875)
Financial assets - available for sale	(1,509)	2,964
Financial assets - held to maturity	888	(2,923)
Loans and receivables to credit institutions	132,937	76,828
Loans and receivables to customers	142,442	(86,188)
Derivatives - hedge accounting	-	-
Other assets from operating activities	8,844	7,184
Financial liabilities - held for trading	1,200	(1,072)
Financial liabilities designated at fair value through profit or loss	24,481	13,103
Financial liabilities measured at amortised cost	35,845	116,531
Deposits from banks	(135,679)	(10,951)
Deposits from customers	157,004	121,802
Debt securities issued	14,520	5,680
Other liabilities from operating activities	12,356	(2,210)
Cash flow from operating activities	**196,476**	**141,826**
Proceeds of disposal		
Financial assets - held to maturity	105,944	47,313
Financial assets - available for sale	58,544	65,987
Property and equipment, intangible assets and investment properties	86	426
Acquisition of		
Financial assets - held to maturity	(248,769)	(259,622)
Financial assets - available for sale	(106,539)	(58,926)
Property and equipment, intangible assets and investment properties	(11,850)	(21,731)
Cash flow from investing activities	**(202,584)**	**(226,553)**
Capital increases	77,974	-
Subordinated loan repayment	(77,685)	-
Cash flow from financing activities	**289**	**-**
Cash and cash equivalents at beginning of period	**111,869**	**106,050**
Cash flow from operating activities	196,476	141,826
Cash flow from investing activities	(202,584)	(226,553)
Cash flow from financing activities	289	-
Cash and cash equivalents at end of period	**106,050**	**21,324**
Cash flows related to taxes, interest and dividends		
Payments for taxes on income (included in cash flow from operating activities)	3,988	5,226
Interest received	74,322	78,976
Dividends received	28	81
Interest paid	(12,704)	(8,184)

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 2017, the direct parent of the Bank– owning 70% of the shares – was Erste Group Bank AG, whose registered office at that date was Am Belvedere 1, 1100 Vienna, Austria. The Consolidated Financial Statements of Erste Group are prepared by the ultimate parent of Erste Group 'Erste Group Bank AG', and are available after their completion at the Court of Registry of Vienna, Marxergasse 1a, 1030 Vienna, Austria.

As of 31 December 2017, DIE ERSTE oesterreichische Spar-Casse Privatstiftung ('ERSTE Foundation), a foundation, holds together with its partners to shareholder agreements approximately 29.62% of the shares in Erste Group Bank AG and is with 15.62% main shareholder. The Erste Foundation is holding 6.5% of the shares directly, the indirect participation of the ERSTE Foundation amounts to 9.12% of the shares held by Sparkassen Beteiligungs GmbH & Co KG, which is an affiliated company of the ERSTE Foundation and affiliated with Erste Group Bank AG through the Haftungsverbund. 9.92% of the subscribed capital is held by the ERSTE Foundation on the basis of a shareholder agreement with CaixaBank A.S. 3.08% are held by other partners to other shareholder agreements.

Hungarian State and EBRD acquired minority stakes in Erste Bank Hungary Zrt.
In June 2016 Corvinus Nemzetközi Befektetési Zrt. (representing the Hungarian State) and the European Bank for Reconstruction and Development (EBRD) signed the contractual framework with Erste Group Bank AG to acquire minority equity stakes of 15 per cent each in Erste Bank Hungary Zrt. The purchase price was 77.78 billion forint. After the regulatory approvals regarding the transaction and completion of other conditions of the contracts, the transfer of ownership occurred in August 2016.
The share purchase was approved by the National Bank of Hungary (NBH) on August 4, 2016 (H-EN-I-693/2016), and the change in the ownership was registered in the company register on August 24, 2016
The new ownership structure of Erste Bank Hungary Zrt. is the following:

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

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

Subsidiaries

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The subsidiaries of the Bank, all registered in Hungary, as of 31 December 2017 are as follows:

Interest of Erste Bank Hungary in % - directly or indirectly			
Company name	**2016**	**2017**	**Core activity**
Erste Befektetési Zrt.	100%	100%	brokerage services
Erste Lakáslízing Zrt.	100%	100%	financial leasing of properties
Erste Ingatlan Kft.	100%	100%	property management
Sió Ingatlan Invest Kft.	100%	100%	property development
Erste Lakástakarék Zrt.	100%	100%	building society
Erste IN-FORG Kft.	100%	0%	property management, legally merged into Collat-Reál Kft
Collat-Reál Kft.	100%	100%	property management
Erste Jelzálogbank Zrt.	100%	100%	refinancing activity

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

B. ACQUISITIONS, MERGERS AND DISPOSALS

Erste IN-FORG Kft. .
On July 3, 2017 Erste IN-FORG Kft. legally merged into Collat-Reál Kft. Both entities were 100% owned by Erste Ingatlan Kft that is solely owned by Erste Bank Hungary therefore this legal merger is a merger between commonly owned entities therefore was no direct impact on the consolidated financial statements of the Bank.

Purchase of Citibank's Hungarian retail banking and cards business
In February 2017 the Bank completed one of the largest bank portfolio acquisitions in the last 10 years by acquiring the Hungarian consumer banking business of Citibank Europe plc. The transaction resulted in Erste Bank Hungary having the second largest retail customer portfolio in Hungary. As part of the acquisition process, making headway in asset management, the Bank launched the new Erste World segment in March 2016, expanding its mass-affluent and private banking services.
Conforming to the scale and complexity of the deal, the acquisition contract provided a 90 day post-migration period for the parties in order to calculate and finalise the purchase price.

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

	number of accounts	amount in billion forint
credit cards (pieces w/o partner card)	92,000	33.5
loans	14,000	17.1
deposits	92,000	168.2
securities under management	6,400	141.2

Given the short nature of the purchased financial instruments there is no difference between the fair value and the actual amount the customers ows to the Bank. The migration excluded defaulted deals based on Citi's accounting/risk policies.

The whole purchase price was paid in cash including the price of the migrated client portfolios and the price of fixed assets taken over as well. Based on the final purchase price data and the migrated amounts after the post-migration finalisation the bank recognised intangible assets of customer relationship (7.89 billion forint) and gain on acquisition (0.374 billion forint), presented in Note 9, page 34 as other operating result.

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The bargain purchase resulted from two main factors. On one side the negotiated purchase price was favourable. On the other side at the time of purchase price allocation (PPA) the Bank was able to use the latest churn information, which were better than the expectations used at purchase price calculation.

The migrated portfolio generated 3.6 billion forint profit before tax result in 2017.

C. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS

(i) Banking tax

The Act LIX of 2006 related to the 'Banking tax' was subject to modification for 2017. The basis of the adjusted balance sheet total of business year 2009 changed to the business year of the second fiscal year before the tax year. The rate to apply for financial institutions above a balance sheet total of 50 billion forint in 2016 was 0.24%, while in 2017 0.21%. Up to 50 billion forint balance sheet total the rate was 0.15% in both years.

D. ACCOUNTING POLICIES

a) BASIS OF PREPARATION

The consolidated financial statements of Erste Hungary for the 2017 financial year and the comparable data for 2016 were prepared in compliance with applicable International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) published by the International Accounting Standards Board (IASB) and with their interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC, formerly Standing Interpretations Committee or SIC) as adopted by the European Union. Except as otherwise indicated, all amounts are stated in millions of Hungarian forint (HUF).

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

The consolidated financial statements for the year ended 31 December 2017 were authorised for issue in accordance with a resolution of the directors on 13 April 2018.

Basis of consolidation

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

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

b) ACCOUNTING AND MEASUREMENT METHODS

Foreign currency translation

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

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

Financial instruments – recognition and measurement

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

Erste Hungary uses the following measurement categories:

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

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

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

(i) Date of recognition

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

(ii) Initial measurement of financial instruments

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

(iii) Cash and cash equivalents with central bank

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

(iv) Financial assets and financial liabilities - Derivatives

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

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

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

(vi) Financial assets – available for sale

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

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

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

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

(vii) Financial assets - held to maturity

Held to maturity financial investments reported as 'Financial assets – held to maturity' in the Statement of Financial Position are non-derivative financial assets, with fixed or determinable payments, and fixed maturities, if Erste Hungary has the intention and ability to hold them until maturity. After initial recognition held to maturity financial investments are subsequently measured at amortised cost including impairment. Interest earned on financial assets - held to maturity is reported in 'Net interest income', using the effective interest rate method. Losses arising from impairment of such investments are recognised in the income statement in 'Other operating result'.

Realised gains or losses from selling are recognised in 'Gains / losses from financial assets not measured at fair value through profit or loss'.

If Erste Hungary were to sell or reclassify more than an insignificant amount of held–to–maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available for sale.

Furthermore, Erste Hungary would be prohibited from classifying any financial asset as held to maturity during the following two years.

(viii) Loans and receivables

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

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

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

(ix) Deposits and other liabilities

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

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

Derecognition of financial assets and financial liabilities

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

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

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

Reclassification of financial assets

From Trading portfolio

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

From Available for sale portfolio

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

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

Repurchase and reverse repurchase agreements

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

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

Securities lending and borrowing

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

Determination of fair value

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

Derivatives

Erste Hungary employs only generally accepted, standard valuation models. Net present values are determined for linear derivatives (e.g. interest rate swaps, cross currency swaps, foreign exchange forwards and forward rate agreements) by discounting the recurring cash flows. Plain vanilla OTC options (on shares, currencies and interest rates) are valued using option pricing models of the Black-Scholes class. Erste Hungary uses only valuation models which have been tested internally and for which the valuation parameters (such as interest rates, exchange rates and volatility) have been determined independently.
Derivatives are presented in Level 2 unless the counterparty CVA (credit value adjustment) exceeds the limit of 30 million forint or the CVA influences the net present value over 20%.

Securities

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

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

Impairment of financial assets

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

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

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

(i) Financial assets carried at amortised cost

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

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

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

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

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

(ii) Financial assets - available for sale

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

Collateral valuation and management

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

The revaluation of collateral is done periodically. In case of corporate loans the valuations, and revaluations are undertaken on a case by case basis. For retail residential real estate the individual valuation is performed within the loan application process, while in later periods a statistical method is used with a reference to market indexes. Apart from periodic revaluations, collateral is also assessed when information becomes available that indicates a decrease in the value of the collateral for exceptional reasons.
Erste Hungary reviewed its standards, processes and systems, paying special focus on collateral registration, valuation, insurance and Basel 3 eligibility. Numerous policies have been updated reflecting the lessons from the crisis as well as supervisory requirements. The Collateral Catalogue of Erste Hungary is fully aligned with the Erste Group Collateral Catalogue

Impairment of non–financial assets

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

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

Hedge accounting

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

(i) Fair value hedge

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

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

In the books of Erste Hungary, no hedge accounting is applied for transactions since 2016.

Offsetting financial instruments

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

Leasing

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

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

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

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

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

Property and equipment

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

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

	Useful life in years
Own land and buildings	15 - 50
Office and plant equipment / other fixed assets	4 - 10
IT assets (hardware)	4 - 6

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

Business combinations and goodwill

(i) Business combinations

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

(ii) Goodwill and impairment testing

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

Investment property

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

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

Repossessed assets

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

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

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

Non-current assets classified as held for sale

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

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

Intangible assets

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

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

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

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

Financial guarantees

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

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

Defined employee benefit plans

The defined employee benefit plan operated by Erste Hungary is for jubilee benefits to which all employees are entitled. Jubilee benefits (long service/ loyal-service benefits) are gifts and vouchers tied to the length of employees' service to an employer., expensed in the relevant year. 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.

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Provisions

Provisions are recognised when Erste Hungary has a present obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. In the Statement of Financial Position provisions are reported under 'Provisions'. They include credit risk provisions for off-balance-sheet transactions (particularly warranties, guarantees and other credit commitments) as well as provisions for litigations and restructuring. Expenses or income from releases relating to credit risk provisions for off-balance-sheet items are presented in the income statement as 'Other operating results'. All other expenses or income from releases related to provisions are reported within 'Other operating result'.

Share-based payment transactions

From 2011, in accordance with Erste Hungary's Remuneration Policy – which is based on CRDIV by EU (Capital Requirements Directive IV, 2013/36/EU of the European Parliament and of the Council) on remuneration policies and the Hungarian Banking Act - management board members are recognized as identified staff. 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. This is effective from the 2011 performance year.

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 forthcoming years. According to this Act each financial institution - that already had a closed financial year and related financial statements on 1 July 2010 - would be subject to assessment and payment of the banking tax. The basis and the rate of the banking tax that is payable differs depending on the type of financial institution. The rates are uniformly based on statutory reported financial data of the reporting entity for the period ended 31 December 2009 till 31 December 2016 and was changed to the second fiscal year before the tax year from 1 January 2017. For credit institutions the tax rates are 0.15% of adjusted total asset value for the first 50 billion forint; and 0.21% (0.24% in 2016) for the amount exceeds 50 billion forint. For investment companies the tax base is the income from investment service activities less expenses on investment service activities shown in the annual report by local GAAP for the year 2009 till 31 December 2016 and was changed to the second fiscal year before the tax year from 1 January 2017 and the tax rate remained 5.6 %.

In the case of leasing and factoring companies the tax base is the sum of net interest income and net commission and fee income based on statutory reported financial data of the reporting entity for the period ended 31 December 2009 till 31 December 2016 and was changed to the second fiscal year before the tax year from 1 January 2017. The tax rate remained 6.5%.

As the banking tax is payable based on prior year non net income measures it does not meet the definition of income tax under IFRS and is therefore presented as an operating expense in the income statement.

Fiduciary assets

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

Dividends on ordinary shares

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

Recognition of income and expenses

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

(i) Net interest income and dividend income

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

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

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

(ii) Net fee and commission income

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

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

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

(iii) Net trading and fair value result

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

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

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

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

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

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

(vi) Other operating result
Other operating result mainly reflects all other income and expenses not attributable to Erste Hungary's core activities. This includes the write down or reversal of write down as well as results on the sale of property and equipment, and result of debt collection, income from the release of and expenses for allocations to other provisions, including provision for guaranteed and credit lines, and non-netting items, like levies on banking activities, local taxes, insurances.

(vii) Government grant
Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed. When the grant relates to an asset, it is recognised as income in equal amounts over the expected useful life of the related asset.
Erste Hungary recognises government grant related to assets, presented within line item 'Other operating income'. Until reasonable assurance earned government grant is presented as deferred income within line item 'Other liabilities'.
Details see in Note 9, page 34 and Note 26, page 48.

Significant accounting judgements, assumptions and estimates

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

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

Fair value of financial instruments
Where the fair values of financial assets and financial liabilities recorded in the Statement of Financial Position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment is required to establish fair values. Disclosures for valuation models, fair value hierarchy and fair values of financial instruments can be found in Note 36) Fair value of financial and non-financial instruments.

Impairment of financial assets

Erste Hungary reviews its financial assets not measured at fair value through profit or loss at each balance sheet date to assess whether an impairment loss should be recorded in the income statement. In particular, it is required to determine whether there is objective evidence of impairment as a result of loss event occurring after initial recognition and to estimate the amount and timing of future cash flows when determining the impairment loss. At defining the amount of impairment the fair value of the eventual collateral is taken into consideration, based on assumptions.
Disclosures concerning impairment are included in Note 35.6) Risk Management, Credit risk.

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

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

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

Provisions
A provision is recognized by Erste Group when it has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.
In the Statement of Financial Position, provisions are reported under 'Other provisions'. They include credit risk provisions for off-balance-sheet transactions (particularly warranties and guarantees) as well as provisions for litigations and restructuring. Based upon historical experience and expert reports Erste Hungary assesses the likelihood and the amount of potential financial losses which are appropriately provided for.

Purchase price allocation (PPA)
During valuation of intangible assets, Erste Hungary follows the guidance outlined in IFRS 3 and the principles of International Valuation Application 1 –Valuation for Financial Reporting. Three traditional methodologies are employed in determining the fair value of a business enterprise or asset includes the market, cost, and income approaches:

1) Income Approach
   a) DCF method
   b) Relief-from Royalty Method
   c) Excess Earnings Method
2) Market approach
3) Cost approach

Gain from bargain purchases
Erste Hungary recognise bargain purchase as of the acquisition date measured as the excess of (a) over (b) below:

(a) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with IFRS 3.
(b) the aggregate of:
   - the consideration transferred measured in accordance with IFRS 3;
   - (the amount of any non-controlling interest in the acquiree measured in accordance with IFRS 3.

The resulting gain related to bargain purchases are recognized in profit or loss for the period on the acquisition date.

Segment reporting

The Bank's segmental reporting is based on the following operating segments: Retail, Corporates (including Small and Medium Enterprises (SME), Local Large Corporate (LLC), Group Large Corporate (GLC), Public Sector (PS) and Commercial Real Estate (CRE)), Group Markets (including Group Markets Trading (GMT) and Group Markets Financial Institutions (GMFI)), Asset/Liability Management & Local Corporate Center (comprises Assets and Liabilities Management (ALM), Corporate Centre and Free capital) Erste Hungary does not report its geographical markets because it primarily carries on its business activities in Hungary and has no significant activities abroad.

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

APPLICATION OF AMENDED AND NEW IFRS/IAS

The accounting policies adopted are consistent with those used in the previous financial year except for standards and interpretations that became effective for financial years beginning after 1 January 2017. As regards new standards and interpretations and their amendments, only those that are relevant for the business of Erste Hungary are listed below.

Effective standards and interpretations

The following standards and their amendments have become mandatory for our financial year 2017, endorsed by the EU:

- Amendments to IAS 7: Disclosure Initiative
- Amendments to IAS 12: Recognition of deferred tax assets for unrealised losses
- Annual Improvements to IFRSs 2014-2016 Cycle (amendments to IFRS 12)

Application of the above mentioned amendments did not have a significant impact on Erste Group's financial statements.

Standards and interpretations not yet effective

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

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

- Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement
- Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures
- Amendments to IAS 40: Transfers of Investment Property
- Annual Improvements to IFRSs 2015-2017 Cycle (amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23)
- IFRIC 22: Foreign Currency Transactions and Advance Consideration
- IFRIC 23: Uncertainty over Income Tax Treatments
- IFRS 17 Insurance contracts

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

- IFRS 9: Financial Instruments
- IFRS 15: Revenue from Contracts with Customers including Amendments to IFRS 15: Effective date of IFRS 15
- Clarifications to IFRS 15 Revenue from Contracts with Customers
- IFRS 16: Leases
- Annual Improvements to IFRSs 2014-2016 Cycle (amendments to IAS 28 and IFRS 1)

IFRS 9: Financial Instruments (IASB Effective Date: 1 January 2018). IFRS 9 was issued in July 2014 and is effective for annual periods beginning on or after 1 January 2018. IFRS 9 addresses the classification and measurement of financial assets and liabilities, introduces new principles for hedge accounting and a new impairment model for financial assets.

Erste Hungary has reviewed its financial assets and financial liabilities in order to evaluate the impact of the first application of IFRS 9 on Erste Hungary's equity and regulatory capital as of 1 January 2018 ('transition impact'). This review involved iterative financial impact studies which continued throughout 2017. Furthermore, starting with the second half of 2017, a fully-fledged parallel run of the IAS 39 production environment and the IFRS 9 test environment has been undertaken in multiple iterations. This parallel run provided significant benefits with regards to ensuring a technically correct transition to IFRS 9, but also with regards to refining the transition impact expectations. At the same time, the parallel run outputs bear an inherent degree of approximation that has been reducing along with different IFRS 9-driven functionalities being user-tested and transferred into production. Post-transition activities will continue throughout the year 2018, notably in respect of:

- finalisation of the testing and assessment of controls over new IT-systems and changes to their governance framework;
- validation and potential refinement of the models for expected credit loss calculations;
- updating the policy landscape in all business lines directly or indirectly affected by IFRS 9.

IFRS 9 introduces two criteria for classification and measurement of 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 ('AC') only if both of the following 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 ('held to collect') 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 ('SPPI') on the principal amount outstanding. Measurement at fair value through other comprehensive income ('FVOCI') is applicable to financial assets held within a business model whose objective is achieved by both collecting contractual cash flows and selling the assets ('hold and sell') while the condition b) is also fulfilled. All other financial assets are measured at fair value through profit or loss ('FVTPL'). The main impacts resulting from the classification and measurement model upon transition to IFRS 9 are described below.

In respect of the business model criterion, the main changes relate to financial assets classified as held-to-maturity and thus measured at AC under IAS 39. Debt securities at a carrying amount of EUR 11 billion will be measured at FVOCI since their value is expected to be realised either by collecting contractual cash flows or through sales.

In applying the business model criterion Erste Hungary has to assess the expected selling activity of financial assets. At Erste Hungary, sales due to increases in credit risk, sales close to assets' maturity, infrequent sales triggered by a non-recurring event (such as changes in regulatory environment, severe liquidity crisis) are considered as not contradicting the 'held to collect' business model. Other kinds of sales are expected to be insignificant as to their volume. As a result, sales are incidental in the 'held to collect' business model. On the other hand, in the 'hold and sell' business model the sales of debt securities are significant and frequent and thus they are integral to meeting the business model objectives. Erste Hungary will carry out such sales in order to optimise the liquidity position or to realise the fair value gains or losses.

Regarding the contractual cash flows characteristics criterion Erste Hungary concluded that the vast majority of its loan portfolio is currently classified as loans and receivables will continue to be measured at AC. The portfolio to be measured at FVTPL represents roughly 4% of 'loans to customers'; such loans typically bear interest mismatch features. This outcome reflects completion of all mitigation activities undertaken since 2015 to reduce the volume of loans which would otherwise have been subject to FVTPL measurement.

Investments in equity instruments at a carrying amount of approximately 970 million forint currently categorised as available-for-sale will be categorised as FVTPL.

Regarding classification and measurement of financial liabilities, upon transition to IFRS 9, Erste Hungary will keep the current classification being that negative derivatives fair values will remain as FVTPL, the rest of the financial liability portfolio will remain as measured at AC, except the already existing issued mortgage bond portfolio that is in the designated FVTPL category.

The new impairment model requires recognition of credit loss allowances ('CLA') based on expected credit losses ('ECL') rather than only incurred credit losses as is the case under IAS 39. It applies to credit risk exposures stemming from debt instruments classified at AC or FVOCI, lease receivables, financial guarantee contracts and certain loan commitments.

For credit risk exposures that are not credit-impaired at initial recognition, Erste Hungary will recognise CLA at an amount equal to 12-month ECL (referred to as 'Stage 1') for as long as no significant increase in credit risk since initial recognition ('SICR') is identified at the reporting date. In the other cases, the CLA is measured at lifetime ECL and the related instruments are referred to as

‘Stage 2’, unless they are found to be credit-impaired at the reporting date (referred to as ‘Stage 3’). For purchased or originated credit-impaired financial assets (‘POCI’), adverse changes in lifetime ECL after the initial recognition are distinctly recognised as CLA, and favourable changes are recognized as ‘Net impairment release/(loss) on financial assets’, increasing the carrying amount of the related POCI assets. The measurement of ECL reflects a probability-weighted outcome, the time value of money and reasonable and supportable forward-looking information.

For lease receivables and trade receivables containing a significant financing component (where Erste Hungary also includes its factoring receivables), IFRS 9 allows a simplified impairment approach, whereby credit loss allowances are always measured at lifetime ECL. Erste Hungary will not apply this simplification.

In the area of ECL modelling and CLA calculation, Erste Hungary has identified a number of key drivers, as follows:

a) the ‘credit-impaired’ definition

In respect of applying the ‘credit-impaired’ concept of IFRS 9, Erste Hungary generally adopted the approach of aligning it with the regulatory concept of ‘default’ for lending exposures. If the default status exists already at an exposure’s initial recognition (e.g. in the context of a significant distressed restructuring), then that exposure is identified as POCI.

b) the SICR indicators applicable to not credit-impaired exposures

Across portfolios and product types, a number of quantitative and qualitative SICR indicators have been defined, in addition to the SICR indicator of 30 days-past-due.

Thus, SICR is quantitatively measured by reference to the adverse change, since instrument’s initial recognition, in the current annualised remaining lifetime probability of default (‘PD’) and in the current 12-month PD. Significance of such change is assessed by reference to a combination of relative and absolute change thresholds respectively. Current PDs are determined to reflect the current default risk as a ‘point-in-time’ measure. The thresholds are established at PD segment and/or client rating level, as appropriate, and are subject to initial and on-going validation.

Qualitative SICR indicators include forbearance-type flags, a work-out transfer flag, information from early-warning-system as well as fraud indicators. The assignment of some specific qualitative indicators inherently relies on experienced credit risk judgment being exercised adequately and timely. Besides the qualitative indicators defined on client level, the assessment of significant increase in credit risk is performed on portfolio level if the increase in credit risk on individual instrument or client level is only available with a certain time lag or is observable exclusively on portfolio level.

Upon transition to IFRS 9 the SICR has to be determined in respect of PDs which existed at instruments’ initial recognition. Where retrospective identification PDs at initial recognition was not possible without undue cost or effort, Erste Hungary implemented the following sequence of approximation methods: closest rating to initial recognition within three months, best possible rating for the relevant portfolio at the time. In case of defaulted loans that were converted to HUF in 2015 and were upgraded afterwards the post-upgrade rating was used.

Application of the ‘low credit risk exemption’ allowed by IFRS 9 for ‘investment grade’ or other ‘low risk’-deemed assets (and resulting in 12 months expected credit losses being calculated irrespective of SICR quantitative measures) is not applied by Erste Hungary.

c) ECL modelling

The key risk parameters used in the measurement of ECLs - PD, loss given default ('LGD') and exposure at default ('EAD') - are derived from internally developed statistical models and other historical data that leverage regulatory models.

The PD describes a probability that a client will default. The 12-month PD reflects the estimated probability of default within one year from the reporting date, whilst the lifetime PD indicates the estimated probability of default until instrument's maturity and cumulates incremental 12-month PD estimates attributable to each year until maturity. The applicable estimation methods used for different PD segments include average default rate analysis and internal/external migration matrices and consider adjustments to the point-in-time-estimate.

The LGD captures the loss rate in the case of default. In general, the selection of estimation method depends on portfolio, and whether the curve is defined on LGD segment, client or account level. The LGD estimation methods applicable in Erste Hungary include a single scenario approach and an advanced multiple scenario approach. For defaulted exposures, LGD curve based on time spent in default is used.

The EAD that is attributable to any given future year throughout an on-balance exposure's remaining maturity is approximated on the basis of exposure's current gross carrying amount multiplied by an amortization coefficient that depends on exposure's contractual repayment schedule. For off-balance not credit-impaired exposures, the EAD approximation also uses credit conversion factor ('CCF') that is the estimated ratio of the off-balance exposure turning into on-balance in the future.

d) Consideration of forward-looking information ('FLI')

Measurement of ECLs and SICR assessment require further consideration of FLI, which Erste Hungary has addressed by introducing a baseline forecast and a number of alternative scenarios for selected macroeconomic variables. These are derived as a deviation from baseline forecasts, where the baseline forecasts are, with a few exceptions, internally determined by Erste Bank Hungary's research department. Given multiple scenarios, the 'neutral' PD (with a few exceptions) are adjusted through macro models which link relevant macroeconomic variables with risk drivers[1]. Thus, the unbiased ECL is derived as weighted average of each macroeconomic scenario. Typical macroeconomic variables may include real gross domestic product, unemployment rate, inflation rate, production index as well as market interest rates. The selection of variables also depends on the availability of reliable forecasts for the given market.

e) Period of exposure to credit risk

Apart from using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, since initial recognition, Erste Hungary will measure ECLs considering the risk of default over the maximum contractual period (including any borrower's extension options). This extends to the date at which Erste Hungary has the right to require repayment of an advance or terminate a loan commitment or guarantee.

However, for revolving credit facilities with unspecified maturity and/or cancellable at short notice and for which the day-to-day internal credit risk management activities are customarily performed on a portfolio basis only, an estimated 5 years horizon is used as the period what CLA is to be accounted for by Erste Hungary. Retail credit cards and overdrafts are among the exposure types the most relevant for such estimates.

Transition to IFRS 9 is expected to result in a decrease of the 2018 opening balance of credit loss allowances compared to the 2017 closing balance of loan loss provisions under IAS 39 (including provisions for off-balance exposures treated under IAS 37) by 9.5%, amounting to 5,965 million forint.

This expected decrease is the combined effect of:

(i) - 4,147 million forint resulting from reversal of loss allowances recognized upon the initial application of the expected credit loss model to credit exposures in the scope of the impairment requirements of both IAS 39/IAS 37 and IFRS 9;

(ii) - 1,837 million forint resulting from reversing loan loss provisions in respect of credit exposures in the scope of the impairment requirements of IAS 39 but outside the scope of the impairment requirements of IFRS 9 (such as loans measured at fair value through profit or loss under IFRS 9), and

[1] Effect of economic cycle on LGD is also planned to be implemented.

(iii) + 19 milllion forint resulting from new loss allowances in respect of credit exposures in the scope of the impairment requirements of IFRS 9 but for which no loan loss provisions were recognized under IAS 39 (such as financial assets which were previously classified as available-for-sale).

Overall, the IFRS 9 transition is expected to result in a before-tax increase of Erste Hungary's consolidated accounting equity by approximately 3,705 million forint, thereof approximately 3,773 million forint relates to retained earnings (accumulated effects which would have impacted profit or loss in previous periods, in connection with all financial instruments subject to classification-driven re-measurement and/or ECL calculation upon transition) and approximately 68 million forint to accumulated OCI (accumulated effects which would have impacted other comprehensive income in previous periods, in connection with financial assets classified at FVOCI upon transition). The related deferred tax impact depends on the fiscal treatment of the incremental differences between the tax values and the IFRS 9-based re-measured accounting values of the affected assets and liabilities. Currently, Erste Hungary estimates that the consolidated deferred tax impact upon transition to IFRS 9 is likely to be neutral as the overall impact resulted deferred tax asset that is not yet to be recognized. Erste Group does not apply the transitional provisions for IFRS 9 acc. to Art. 473a CRR (Capital Requirements Regulations, Regulation (EU) No 575/2013 of the European Parliament and of the Council) when calculating regulatory own funds.

The new standard also resulted in amended IFRS requirements regarding presentation and disclosure. These are expected to change the nature and extent of the group's disclosures about its financial instruments particularly in the year of the adoption of the new standard.

IFRS 15 Revenue from Contracts with Customers (IASB Effective Date: 1 January 2018). IFRS 15 was issued in May 2014 and is effective for annual periods beginning on or after 1 January 2018. Clarifications to IFRS 15 were issued in April 2016. IFRS 15 specifies how and when an entity recognises revenue from contracts with customers. It also requires such entities to provide users of financial statements with more informative and more relevant disclosures. The standard provides a single, principles based five-step model to be applied to all contracts with customers. Also in the areas of variable considerations and capitalisation of cost IFRS 15 provides modified regulations. The standard is not focused on recognition of revenues from financial instruments. Hence, on the basis of the analyses performed throughout 2017, the application of this standard is not expected to have a significant impact on Erste Hungary's financial statements.

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

The analysis and planning of proper IT solutions for the requirements of IFRS 16 have continued throughout 2017. At the same time the assessment of the contracts has been in focus. The role out of proper IT structure is planned to be realised in 2018.

Since the analysis of the impact of IFRS 16 has not yet been completed, no quantitative estimates with respect to the effects of the transition to IFRS 16 can be made at this time.

Regarding the transition method Erste Hungary is planning to follow the modified retrospective approach with recognition of the adjustments arising out of the first time application of IFRS 16, if any, in equity at the date of initial application. The applicable discount rate will be the one determined at the date of initial application.

Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions (IASB effective date: 1 January 2018). Amendments to IFRS 2 were issued in June 2016 and are effective for annual periods beginning on or after 1 January 2018. The amendments clarify treatment for the effects of vesting conditions on a cash-settled share-based payment transaction, the classification of a share-based payment with net settlement features for withholding tax obligations and the accounting for modifications of share-based payment transactions from cash-settled to equity-settled. Application of these amendments is not expected to have a significant impact on Erste Hungary's financial statements.

Amendments to IAS 19: Plan Amendment, Curtailment or Settlement (IASB effective date 1 January 2019). Amendments to IAS 19 were issued in February 2018 and are effective for annual periods beginning on or after 1 January 2019. The amendments require that if a plan amendment, curtailment or settlement occurs, it is mandatory that the current service cost and the net interest for the period after the remeasurement are determined using the assumptions used for the remeasurement. In addition, the amendments clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling. Application of these amendments is not expected to have a significant impact on Erste Hungary's financial statements.

Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures (IASB effective date 1 January 2019). Amendments to IAS 39 were issued in October 2017 and are effective for annual periods beginning on or after 1 January 2019. The amendments clarify that a company applies IFRS 9 Financial Instruments including its impairment requirements to long-term interests in an associate or joint venture that form part of the net investment in the associate or joint venture. Application of these amendments is not expected to have a significant impact on Erste Hungary's financial statements.

Amendments to IAS 40: Transfers of Investment Property (IASB effective date: 1 January 2018). Amendments to IAS 40 were issued in December 2016 and are effective for annual periods beginning on or after 1 January 2018. The amendments reinforce the principle for transfers into, or out of, investment property in IAS 40 and specify that such a transfer should only be made when there has been a change in use of the property. Application of these amendments is not expected to have a significant impact on Erste Hungary's financial statements.

Annual Improvements to IFRSs 2014-2016 Cycle (IASB effective date: 1 January 2017 and 1 January 2018). In December 2016, the IASB issued a set of amendments to various standards. The amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after 1 January 2018. Application of these amendments is not expected to have a significant impact on Erste Hungary's financial statements.

Annual Improvements to IFRSs 2015-2017 Cycle (IASB effective date: 1 January 2019). In December 2017, the IASB issued a set of amendments to various standards. The amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23 are effective for annual periods beginning on or after 1 January 2019. Application of these amendments is not expected to have a significant impact on Erste Hungary's financial statements.

IFRIC 22: Foreign Currency Transactions and Advance Consideration (IASB effective date: 1 January 2018). IFRIC 22 was issued in December 2016 and is effective for annual periods beginning on or after 1 January 2018. The interpretation relates to considerations denominated in a foreign currency received or paid in advance of the recognition of the related asset, expense or income. It clarifies, that the date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability in such cases. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. Application of the interpretation is not expected to have a significant impact on Erste Hungary's financial statements.

IFRIC 23: Uncertainty over Income Tax Treatments (IASB effective date: 1 January 2018). IFRIC 23 was issued in June 2017 and is effective for annual periods beginning on or after 1 January 2019. The interpretation is to be applied to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. An entity is required to use judgement to determine whether each tax treatment should be considered independently or whether some tax treatments should be considered together. If the entity concludes that it is not probable that a particular tax treatment is accepted by a taxation authority, the entity has to use the most likely amount or the expected value of the tax treatment. Otherwise the treatment used in the tax filings is applied. An entity has to reassess its judgements and estimates if facts and circumstances change. Application of the interpretation is not expected to have a significant impact on Erste Hungary's financial statements.

IFRS 17: Insurance Contracts (issued on 18 May 2017 and effective for annual periods beginning on or after 1 January 2021). IFRS 17 replaces IFRS 4, which has given companies dispensation to carry on accounting for insurance contracts using existing practices. As a consequence, it was difficult for investors to compare and contrast the financial performance of otherwise similar insurance companies. IFRS 17 is a single principle-based standard to account for all types of insurance contracts, including reinsurance contracts that an insurer holds. The standard requires recognition and measurement of groups of insurance contracts at: (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus (if this value is a liability) or minus (if this value is an asset) (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin). Insurers will be recognising the profit from a group of insurance contracts over the period they provide insurance coverage, and as they are released from risk. If a group of contracts is or becomes loss-making, an entity will be recognising the loss immediately. Application of the interpretation is not expected to have a significant impact on Erste Hungary’s financial statements.

E. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1) Net interest income

in HUF million	2016	2017
Interest income		
Financial assets - held for trading	4,046	3,735
Financial assets - available for sale	1,606	2,509
Financial assets - held to maturity	11,830	13,759
Loans and receivables	54,720	54,809
Total interest income	**72,202**	**74,812**
Interest expenses		
Financial liabilities - measured at fair value through profit and loss	(1,359)	(917)
Financial liabilities measured at amortised cost	(14,047)	(8,423)
Total interest expense	**(15,406)**	**(9,340)**
Net interest income	**56,796**	**65,472**

The interest income related to the non-performing portfolio is 1,682 million forint in 2017 and 3,642 million forint in 2016.

2) Net fee and comission income

in HUF million	2016	2017
Lending business	2,129	2,240
Payment transfers	21,955	24,472
Card business	9,993	13,529
Securities business	14,295	17,278
Investment fund transactions	5,819	8,108
Custodial fees	1,566	1,588
Brokerage	6,911	7,582
Insurance brokerage	2,458	3,052
Building society brokerage	178	308
Investment banking business	2,440	3,573
Other fee and commission income	1,053	732
Fee and commission income - total	**54,501**	**65,184**
Lending business	(1,668)	(2,267)
Payment transfers	(2,008)	(2,587)
Card business	(3,820)	(5,608)
Securities business	(2,545)	(3,121)
Investment fund transactions	(759)	(794)
Custodial fees	(187)	(227)
Brokerage	(1,599)	(2,100)
Insurance brokerage	(18)	(18)
Building society brokerage	(19)	(1)
Investment banking business	(66)	(243)
Other fee and commission expense	(198)	(2,656)
Fee and commission expense - total	**(10,340)**	**(16,501)**
Net fee and commission income	**44,161**	**48,683**

3) Dividend income

in HUF million	2016	2017
Financial assets - available for sale	28	81
Dividend income	**28**	**81**

4) Net trading and fair value result

in HUF million	2016	2017
Securities	3,601	2,141
Derivatives	3,676	(2,931)
Foreign exchange transactions	(539)	11,655
Net trading and fair value result	**6,738**	**10,865**

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

Net trading and fair value result	**6,738**	**10,865**
Net interest income	**2,688**	**2,818**
Securities	3,178	2,245
Derivatives	(490)	573
Net result of financial instrument valued at fair value through profit and loss	**9,426**	**13,683**

5) Rental income from investment properties & other operating leases

in HUF million	2016	2017
Investment properties	1,236	1,180
Rental income from investment properties & other operating leases	**1,236**	**1,180**

6) General administrative expenses

in HUF million	2016	2017
Personnel expenses	**(28,501)**	**(31,243)**
Wages and salaries	(21,025)	(24,213)
Compulsory social security	(6,343)	(5,847)
Other personnel expenses	(1,133)	(1,183)
Other administrative expenses	**(26,064)**	**(27,517)**
Deposit insurance contribution	(2,300)	(2,682)
IT expenses	(8,105)	(8,895)
Expenses for office space[1)]	(6,496)	(6,603)
Office operating expenses	(2,487)	(2,385)
Advertising/marketing	(2,186)	(1,810)
Legal and consulting costs	(1,819)	(2,607)
Sundry administrative expenses	(2,671)	(2,535)
Depreciation and amortisation	**(6,340)**	**(9,509)**
Software and other intangible assets[2)]	(4,012)	(7,001)
Owner occupied real estate	(700)	(751)
Investment properties	(293)	(298)
Office furniture and equipment and sundry property and equipment	(1,335)	(1,459)
General administrative expenses	**(60,905)**	**(68,269)**

1) ‘Expenses for office space’ includes rental expense related to headquarter office building and branches, presented in Note 30b, page 54 as operating leasing.
2) Amortization of software and other intangible assets increased as a result of the recognized customer list from the Citi deal

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

in Full Time Employee	2016 year end	2016 average	2017 year end	2017 average
Erste Bank Hungary	**2,646**	**2,677**	**2,827**	**2,868**
Fully consolidated subsidiaries	**227**	**225**	**220**	**229**
Erste Befektetési Zrt.	148	149	139	147
Erste Lakáslízing Zrt.	-	-	-	-
Erste Ingatlan Kft.	28	33	26	27
Erste Lakástakarék Zrt.	38	33	40	42
Erste Jelzálogbank Zrt.	13	10	15	13
Total	**2,873**	**2,902**	**3,047**	**3,097**

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

in HUF million	2016	2017
Available- for-sale financial assets	**(309)**	**(448)**
Loans and receivables to customers	**(4,988)**	**3,252**
Allocation to risk provisions	(46,831)	(28,008)
Release of risk provisions	48,755	33,045
Direct write-offs	(9,142)	(5,436)
Recoveries recorded directly to the income statement	2,230	3,651
Net impairment gain/(loss) on financial assets not measured at fair value through profit or loss[1)]	**(5,297)**	**2,804**

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

in HUF million	2016	2017
Banking tax	(6,140)	(3,859)
Transaction tax	(11,703)	(13,118)
Resolution fund	(559)	(1,251)
Other levies on banking activities	(238)	-
Other taxes	(555)	(307)
Insurances	(657)	(586)
Impairment on inventories and receivables[1)]	(1,327)	(566)
Impairment on intangibles	(128)	(241)
Impairment on investment properties	(122)	-
(Allocation)/release of provision for guarantees and credit lines	(14,373)	-
(Allocation)/release of other provisions/risks[6)]	(1,398)	(20,881)
Result from sales of other assets	-	(3,496)
Result of workout activities	(1,155)	-
Other	(41)	(753)
Other operating expenses	**(38,396)**	**(45,058)**

in HUF million	2016	2017
(Allocation)/release of provision for guarantees and credit lines[6)]	-	21,792
Result from sales of other assets	3,643	-
Result from sales of properties/movables	16	4,965
Result of workout activities	-	17
FV correction[2)]	171	-
Income from upgrade on loans previously subject to FX settlement[3)]	33,849	8,053
Government grant[4)]	1,657	1,814
Negative goodwill recognised in profit or loss	-	374
FX 1&2 settlement[5)]	540	-
FX 3 settlement[5)]	8	-
Other[7)]	284	1,508
Other operating income	**40,168**	**38,523**

1) The impairment allocation for repossessed assets amounted to 836 million forint recognised in” Impairment on inventories and receivables” (1.1 billion forint in 2016). There was 0.3 million forint (in 2016: nil) reversal due to revaluation. The use of impairment of 268 million forint (2.8 billion forint in 2016) is shown in ‘Result from sales of other asset’ together with the expenses of derecognition and the income of the sale.

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

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

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

The gain of 171 million forint presented in 2016 is coming from the unamortised initial FV correction related to derecognition of three municipality bonds taken over by the Government with which the full original amount of 1.6 billion was amortized into income statement resulting nil amount for 2017..

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

Legally obliged conversion was based on *Conversion law of 2014:LXXVII (passed November 2014)* that introduced the concept of a compulsory conversion of foreign currency denominated consumer loans in-scope into HUF, at a rate fixed by the law. This law was further amended by *FX*

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car loan, financial leasing and unsecured loan conversion law CXLV of 2015 (passed 6 October 2015) to widened the loans subject to the compulsory conversion. In scope are foreign currency denominated consumer mortgage loans, real estate leasing, car loans agreements. The effective conversion date for the first law was 1 February 2015, while the second law was 1 January 2016.

4) Conforming to its accounting policies (see chapter D. Accounting policies, page 10) Erste Hungary recognises government grant in 'Deferred income' till the reasonable assurance on realisation. After reasonable assurance earned, realised government grant is presented within 'Other operating result'.
Details on balances regarding government grant see in Note 26, page 47 .

Erste Hungary recognises government grant related to the following:

- National Bank of Hungary (NBH) security program
  NBH introduced a floating-rate-payer forint interest rate swap (IRS) facility with terms of three and five years starting from June 2014 and one with a term of ten years starting from July 2015. This facility applies some preferential elements to intensify usage of IRS tenders and also additional purchase of government securities by Banks. Banks are entitled to the preferential element if the government security portfolio is kept at a given level. In 2017 266 million forint is presented as government grant related to IRS. The 2016 amount equals to 240 million forint.
- NBH SME lending program (PHP)
  NBH introduced a lending activity linked floating-rate-payer forint interest rate swap (HIRS) with terms of one and three years starting from February 2016. Banks are entitled to the preferential gain if criteria combining growth and stability elements related to lending activity in SME sector are met. In 2017 1,548 million forint is presented as government grant related to HIRS (1,417 million forint in 2016).

5) The 31 December 2016 balance included 548 million forint used and reversed provision for the previous years FX settlement laws (named under subnote 3 above) as the conversion FX rate was fixed and the difference between the legally set FX rate and the actual market FX rate at conversion date had to be recognized as loss by the banks.
6) Erste Hungary was involved into one larger deal which changed its nature from lending business to legal case, therefore the large amounts relates to the same deal in different stages.
7) Includes 348 million forint investment property expense (391 million forint in 2016)

10) Taxes on income

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

Depending on the level of profitability from the second half of 2010 the corporate tax rate has been reduced to a minimum of 10% of the adjusted amount of profit before tax. The portion of the profit before tax of a company which was below 500 million forint was charged with a rate of 10% corporate income tax. If the profit before tax of a company was above this amount the corporate income tax rate was 19% for the portion of the profit above 500 million forint.
Corporate income tax legislation relative for 2017 business year was published and known by the time of issuance of 2016 financial statement. Two-phase progressive tax rate has been changed to general 9% rate.
Conforming to that, deferred tax was calculated by applying the 9% tax rate both for 2017 and for 2016.

Tax implications of prior years FX settlement
FX 1&2
The financial institution was allowed to reduce its corporate income tax from 2016 on with the differential amount of recalculated local business tax, innovation tax, corporate income tax and banking tax. Declared amount and recalculated amounts for the effected period, based on recalculated exposure are compared to define the amount of possible tax refund.
FX 3
The financial institution is allowed to reduce its taxes from 2016 on (corporate tax, special bank tax and financial transaction duty) with

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

The total calculated amount is 6.1 billion forint of which 3.4 billion forint is used in 2016, the remaining amount of 2.7 billion forint was used in 2017.

FX settlement was the following in prior years: In June 2011 the Hungarian Parliament approved the “Home rescue plan” applicable to financial institutions. The main objective of the plan was to provide a benefit for citizens having mortgage loans or residential real estate finance lease contracts denominated in Swiss Franc, Euro or Japanese Yen, as their monthly instalments were significantly impacted by changes in foreign exchange rates. Supreme Court of Hungary (Curia) published a uniformity decision in three topics related to foreign currency denominated loans at 16 June 2014. The principles and its consequences stated in this uniformity decision are incorporated in different legal acts. being *Curia Law*, *Settlement Law* and *Conversion Law*. The first two laws compel financial institutions to reimburse their clients for imposing unfair unilaterally modified interest, fee, charges and for charging bid/ask spread margin that resulted significant losses to the Hungarian banking sector that changed the tax basis retrospectively, however the implication was allowed to be materialized first in the tax year of 2016 as described above.

in HUF million	2016	2017
Current tax expense / income		
Current period taxes	(3,988)	(5,226)
of which local business tax	(3,041)	(4,101)
of which local innovation tax	(450)	(592)
Deferred tax expense / income		
Current period deferred tax benefit / (expense)	(89)	(54)
Total	**(4,077)**	**(5,280)**

Deferred tax related to 'Available for sale reserve' has been recognized in other comprehensive income in the amount of (299) million forint in 2017 and 618 million forint in 2016.

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

in HUF million	2016	2017
Profit before tax	**47,420**	**60,034**
At statutory income tax rate (2016: 19%, 2017: 9%)	(9,010)	(5,403)
Income not subject to tax	1,703	1,125
Non tax deductible expenses	(1,730)	(1,117)
Local business and innovation tax	(3,491)	(4,693)
Tax loss carry forward usage	3,641	3,716
Tax refund related to FX settlement	3,521	2,712
Other	1,289	(1,619)
Total tax expense	**(4,077)**	**(5,280)**

At 31 December 2017 the tax loss carried forward amounts to 168,195 million forint. (2016: 190,938 million forint, respectively) Using the tax loss carried forward is based on the following rules:

- Tax loss carry forwards arisen till 31 December 2014 and before are consumable for a limited period of 10 years, till 31 December 2025 (118,295 million forint);
- Tax loss carry forwards after 31 December 2014 is consumable for a limited period of 5 years, till 31 December 2020 (49,900 million forint).

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

There is no deferred tax asset recognized relating to tax loss carried forward.

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11) Cash and cash balances with central bank

in HUF million	2016	2017
Cash on hand	17,886	19,793
Cash balances at central banks	77,116	500
Other demand deposits	11,048	1,031
Cash and cash balances with central bank	**106,050**	**21,324**

The Bank is obliged to keep a minimum mandatory reserve at the central bank amounting to 1% of its domestic customers' deposits, foreign customers' FX deposits and foreign customers' forint deposits with maturities less than one year. The average of monthly mandatory minimum reserves at 31 December 2017 and 31 December 2016 was 14.35 billion forint and 13.70 billion forint respectively. The minimum mandatory reserve balances are included within the above balances of cash and balances with central banks.

12) Derivatives – held for trading

	2016				2017			
	Positive fair value		Negative fair value		Positive fair value		Negative fair value	
in HUF million	Carrying amount	Notional amount	Carrying amount	Notional amount	Carrying amount	Notional amount	Carrying amount	Notional amount
Derivatives – held for trading	**15,397**	**2,156,052**	**11,337**	**2,161,122**	**21,083**	**3,469,492**	**15,092**	**3,418,807**
Interest rate swaps	7,939	713,466	4,017	713,466	8,293	831,855	4,935	828,753
Currency swaps	4,017	801,562	3,944	801,254	9,705	1,775,502	4,783	1,770,828
Currency forward rate agreement	2,223	479,308	2,175	479,508	1,591	540,624	3,840	543,212
Currency futures	96	6,454	26	6,447	81	6,081	14	6,144
Interest rate options	97	8,506	107	8,506	96	8,490	107	8,490
Currency options	1,005	145,166	1,037	145,168	1,172	257,167	1,244	257,166
Other agreements	20	1,590	31	6,773	145	49,773	169	4,214

13) Other trading assets

in HUF million	2016	2017
Equity instruments	1,401	1,778
Debt securities	116,257	120,844
General governments	116,055	89,744
Credit institutions	202	31,100
Other trading assets	**117,658**	**122,622**

14) Financial assets - available for sale

in HUF million	2016	2017
Equity instruments	2,820	2,159
Debt securities	134,929	134,606
General governments	110,356	114,898
Other financial corporations	24,573	19,708
Financial assets - available for sale	**137,749**	**136,765**

15) Financial assets – held to maturity

	Gross carrying amount		Collective allowances		Net carrying amount	
in HUF million	2016	2017	2016	2017	2016	2017
General governments	432,142	583,356	-	-	432,142	583,356
Credit institutions	4,526	68,544	-	-	4,526	68,544
Total	**436,668**	**651,900**	**-**	**-**	**436,668**	**651,900**

16) Securities

	Loans and receivables to customers and credit institutions		Other trading assets		Available for sale		Financial assets Held to maturity		Total	
in HUF million	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017
Bonds and other interest-bearing securities	**3,959**	**3,288**	**116,257**	**120,844**	**134,929**	**134,606**	**436,668**	**651,900**	**691,813**	**910,638**
Listed	-	-	100,058	48,614	110,356	114,898	414,823	600,159	625,237	763,672
Unlisted	3,959	3,288	16,200	72,230	24,573	19,708	21,845	51,741	66,576	146,967
Equity-related securities	**-**	**-**	**1,401**	**1,778**	**2,041**	**1,331**	**-**	**-**	**3,442**	**3,109**
Listed	-	-	1,388	1,775	-	-	-	-	1,388	1,775
Unlisted	-	-	13	3	2,041	1,331	-	-	2,054	1,334
Equity holdings	-	-	-	-	779	828	-	-	779	828
Total	**3,959**	**3,288**	**117,658**	**122,622**	**137,749**	**136,765**	**436,668**	**651,900**	**696,035**	**914,575**

17) Loans and receivables to credit institutions

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
As of 31 December 2017				
Loans and receivables	68,672	-	-	68,672
Central banks	28,985	-	-	28,985
Credit institutions	39,687	-	-	39,687
Total	**68,672**	**-**	**-**	**68,672**

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

18) Loans and receivables to customers

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
As of 31 December 2017				
Debt securities with customers	3,505	-	(217)	3,288
General governments	2,336	-	(30)	2,306
Other financial corporations	-	-	-	-
Non-financial corporations	1,169	-	(187)	982
Loans and advances to customers	1,178,492	(38,857)	(19,226)	1,120,409
General governments	9,221	(0)	(9)	9,221
Other financial corporations	21,838	(16)	(180)	21,642
Non-financial corporations	466,952	(4,713)	(9,682)	452,557
Households	680,481	(34,128)	(9,355)	636,999
Total	**1,181,997**	**(38,857)**	**(19,443)**	**1,123,697**

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

Allowances for loans and receivables to customers

Risk provisions 2017

in HUF million	01.01.2017	Allocation	Use	Release	Interest income from impaired loans	Exchange rate effect	31.12.2017
Specific provisions	62,935	15,294	(13,960)	(23,568)	(1,682)	(144)	38,875
Portfolio provisions	16,268	12,714	-	(9,477)	-	(80)	19,425
Risk provisions for loans and advances	**79,203**	**28,008**	**(13,960)**	**(33,045)**	**(1,682)**	**(224)**	**58,300**

Risk provisions 2016

in HUF million	01.01.2016	Allocation	Use	Release	Interest in-come from impaired loans	Exchange rate effect	31.12.2016
Specific provisions	104,287	38,619	(37,483)	(38,477)	(3,642)	(369)	62,935
Portfolio provisions	18,408	8,213	-	(10,278)	-	(74)	16,268
Risk provisions for loans and advances	**122,696**	**46,832**	**(37,483)**	**(48,755)**	**(3,642)**	**(443)**	**79,203**

19) Fixed assets movement

Movements in fixed assets schedule

COST in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties
Value 01.01.2017	**41,065**	**2,860**	**9,786**	**5,650**	**9,880**	**69,241**	**11,811**
Additions	5,921	8,566	525	439	1,289	16,740	13
Transfer	-	-	-	-	-	-	-
Disposals	(2,010)	(2)	(783)	(816)	(476)	(4,085)	-
Reclassification	(7)	17	-	-	(9)	-	-
Value 31.12.2017	**44,969**	**11,441**	**9,528**	**5,273**	**10,684**	**81,895**	**11,824**

DEPRECIATION AND IMPAIRMENT in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings[2)]	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties[1)]
Value 01.01.2017	**23,552**	**2,063**	**4,219**	**4,308**	**7,798**	**41,940**	**1,191**
Additions	5,862	1,380	751	454	1,005	9,452	298
Transfer	-	-	-	-	-	-	-
Disposals	(2,010)	(2)	(499)	(680)	(471)	(3,662)	-
Reclassification	-	-	-	-	-	-	(11)
Impairment	-	-	-	-	-	-	-
Value 31.12.2017	**27,404**	**3,441**	**4,471**	**4,082**	**8,332**	**47,730**	**1,478**

NET CARRYING AMOUNT in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties
Value 01.01.2017	**17,513**	**797**	**5,567**	**1,342**	**2,082**	**27,301**	**10,620**
Value 31.12.2017	**17,565**	**8,000**	**5,058**	**1,191**	**2,352**	**34,166**	**10,347**

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

2) The depreciation relates to buildings within ‚Own land and buildings'.

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

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

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

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

2) The depreciation relates to buildings within ‚Own land and buildings'

Net carrying amount

in HUF million	2016	2017
Intangible assets	**18,310**	**25,565**
Software acquired	17,513	17,565
Other intangible assets (licenses, patents, customer lists etc.)	797	8,000
Property and equipment	**8,991**	**8,600**
Own land and buildings	5,567	5,058
Office and plant equipment/other fixed assets	1,342	1,190
IT-assets (hardware)	2,082	2,352
Total intangible and tangible assets	**27,301**	**34,165**
Investment properties	**10,620**	**10,347**

Within fully amortised intangible assets still in use, Erste Hungary has recognised software with a gross value amounting to 4,948 million forint in 2017 and 5,764 million forint in 2016.

20) Tax assets and liabilities

in HUF million	Tax assets 2016	Tax assets 2017	Tax liabilities 2016	Tax liabilities 2017
Deferred taxes	**33**	**-**	**238**	**585**
Financial assets – held for trading	(2)	-	164	-
Financial assets - available for sale	-	-	256	596
Financial assets - held to maturity	-	-	(195)	(81)
Financial liabilities measured at amortised cost	-	-	-	24
Provisions	(2)	-	50	-
Other	37	-	(37)	46
Current taxes	**1,000**	**704**	**9**	**0**
Total taxes	**1,033**	**704**	**247**	**585**

21) Assets held for sale

in HUF million	2016	2017
Assets held for sale	187	1

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

22) Other assets

in HUF million	2016	2017
Clearing accounts with tax authorities	0	640
Other clearing accounts	2,389	3,112
Other financial assets	3,580	3,304
Other accrued income	2,485	3,096
Inventories	301	470
Repossessed assets[1)]	11,151	8,113
Prepaid expenses	4,483	1,831
Other	3,097	7,225
Total	**27,486**	**27,791**

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

The amount of the impairment of the repossessed assets is 0.9 billion forint (in 2016: 1.3 billion forint).

23) Other trading liabilities

in HUF million	2016	2017
Short positions	1,060	70
Equity instruments	1,060	70
Total	**1,060**	**70**

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24) Financial liabilities

Deposits from banks

in HUF million	2016	2017
Deposit from domestic banks	117,261	138,928
Deposit from foreign banks	96,394	63,632
of which by Austrian banks	85,752	62,350
of which subordinated liabilities	50,805	50,666
Total	**213,655**	**202,560**

Deposits from banks - subordinated liabilities

Maturity	Notional amount 2016		Notional amount 2017		Interest conditions
	in thousand EUR	in million HUF	in thousand EUR	in million HUF	
30 September 2021	100,000	31,101	100,000	31,014	3M EURIBOR + 3,92%, quarterly[1)]
30 September 2021[2)]	28,312	8,806	28,312	8,781	3M EURIBOR+ 4,11%, quarterly[1)]
30 June 2021	35,000	10,886	35,000	10,855	3M EURIBOR+ 3,83%, quarterly[1)]
Total subordinated loans	**163,312**	**50,793**	**163,312**	**50,650**	

1) 3M EURIBOR is floored at 0,00%.

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

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

Deposits from customers

in HUF million	2016	2017
Saving deposits	2,360	2,383
Other deposits	1,416,737	1,538,515
Public sector	24,363	52,479
Commercial customers	434,918	452,862
Private customers	643,756	828,479
Other financial institutions	313,700	204,695
Total	**1,419,097**	**1,540,898**

Debt securities issued

in HUF million	2016	Notional amount 2016	2017	Notional amount 2017
Bonds	15,061	15,194	6,036	6,248
of which subordinated liabilities	3,779	4,215	4,043	4,215
Mortgage bonds	47,033	46,368	74,847	72,888
Designated at fair value through profit or loss[1)]	24,481	23,982	37,584	35,592
Measured at amortized cost	22,552	22,386	37,263	37,296
Certificate of deposits	790	790	784	784
Total	**62,884**	**62,352**	**81,667**	**79,920**

1) As it is described in the Accounting policy, the category 'at fair value through profit or loss' is used if such classification eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases. In case Erste Hungary would not opt for valuation at fair value, the carrying amount of mortgage bonds designated at fair value through profit or loss was 36,339 (in 2016: 24,140). By the legislation related to mortgage banks the interest rate risk is prescribed to be hedged. The risk is hedged by interest rate swaps (IRS). The original mismatch to eliminate through fair value option applied for mortgage bond issued is the different valuation base of IRS (at fair value) and mortgage bond issued (at amortised cost).

Debt securities issued - non-subordinated liabilities

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

issued non subordinated securities as at 31 December 2017	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Currency	Interest conditions
Bonds						
ERSTE TARTÓS KÖTVÉNY 20181116	HU0000356688	2015. november 17.	2018. november 16.	161	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180817	HU0000356522	2015. augusztus 19.	2018. augusztus 17.	599	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20181008	HU0000356605	2015. október 7.	2018. október 8.	648	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180102	HU0000356423	2015. június 24.	2018. január 2.	625	HUF	zero coupon
Total				**2,033**		
Mortgage bonds						
EJBFN21A	HU0000652920	2016. október 19.	2021. október 27.	19,315	HUF	fixed 2,50% interest payments: yearly
EJBFN21A	HU0000652920	2016. október 19.	2021. október 27.	18,000	HUF	fixed 2,50% interest payments: yearly
EJBFN19A	HU0000652912	2016. október 19.	2019. október 30.	17,592	HUF	fixed 2,00% interest payments: yearly
EJBFN19A	HU0000652912	2016. október 19.	2019. október 30.	17,981	HUF	fixed 2,00% interest payments: yearly
Total				**72,888**		
certificate of deposit	AT2222222222	1990. január 1.	2016. november 25.	784	HUF	
Total				**784**		

issued non subordinated securities as at 31 December 2016	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Currency	Interest conditions
Bonds						
ERSTE TARTÓS KÖTVÉNY 20181116	HU0000356688	17 November 2015	16 November 2018	161	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20170217	HU0000356092	18 February 2015	17 February 2017	1,335	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180817	HU0000356522	19 August 2015	17 August 2018	599	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20171106	HU0000356340	06 May 2015	06 November 2017	1,444	HUF	zero coupon
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 14	HU0000356571	12 August 2015	11 August 2017	280	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 4.5% p.a.; payable at maturity
ERSTE SÁVOS HOZAMMAX KÖTVÉNY 13	HU0000356274	23 March 2015	22 March 2017	622	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 5% p.a.; payable at maturity
ERSTE TARTÓS KÖTVÉNY 20171002	HU0000356241	01 April 2015	02 October 2017	2,233	HUF	zero coupon
ERSTE RAC 6.75%/2017	HU0000354139	10 February 2014	10 February 2017	1,000	HUF	indexed (linked to EUR/HUF exchange rate); coupon: 6.75% p.a.; interest payments: yearly
ERSTE TARTÓS KÖTVÉNY 20181008	HU0000356605	07 October 2015	08 October 2018	647	HUF	zero coupon
ERSTE FIX+KAMATKÖV KÖTV. 20170703	HU0000354873	02 July 2014	03 July 2017	253	HUF	fixed in the first 6 months (coupon: 5% p.a.) then variable (linked to 6M BUBOR); payable at maturity

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ERSTE FIX USD 20170908	HU0000356878	08 March 2016	08 September 2017	2	USD	fixed; coupon: 2.41% not annualized, payable at maturity
ERSTE TARTÓS KÖTVÉNY 20180102	HU0000356423	24 June 2015	02 January 2018	625	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20170113	HU0000355961	14 January 2015	13 January 2017	1,777	HUF	zero coupon
Total				**10,979**		
Mortgage bonds						
EJBFN21A	HU0000652920	19 October 2016	27 October 2021	12,315	HUF	fixed 2,50% interest payments: yearly
EJBFN21A	HU0000652920	19 October 2016	27 October 2021	12,000	HUF	fixed 2,50% interest payments: yearly
EJBFN19A	HU0000652912	19 October 2016	30 October 2019	11,982	HUF	fixed 2,00% interest payments: yearly
EJBFN19A	HU0000652912	19 October 2016	30 October 2019	10,071	HUF	fixed 2,00% interest payments: yearly
Total				**46,368**		
certificate of deposits	AT2222222222	1990. január 1.	2016. november 25.	790	HUF	
Total				**790**		

Debt securities issued - subordinated liabilities

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

As of 31 December 2016

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

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25) Provisions

in HUF million	2016	2017
Provision for guarantees and committed credit lines[1)]	21,665	3,560
Provision as a precaution	560	351
Provision related to loans and advances	**22,225**	**3,911**
Provision for litigations	86	2,071
Other provision	2,845	2,709
Sundry provision	**2,931**	**4,780**
Total	**25,156**	**8,691**

1) Erste Hungary was involved into one large deal which was finalized during 2017 and the provision was largely used and the remaining amount was reversed when the case was closed.

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.

This category also includes 1.7 billion forint related to a Supreme Court (Curia) decision:

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

Other provision

2017

The determining majority of other provisions are coming from items already recognised in 2016, like 1.78 billion forint warranty like provision related to 'Large debt sale', 551 million forint related to a stamp duty obligation and 160 million forint concerning the residual items out of the legally obliged forced conversion related to factored deals– details see below in comparative period section.

2016

Large debt sale

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

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

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

In addition to 'Large debt sale' provision, 'Other provision' also includes a stamp duty obligation related to properties repossessed in the past of 551 million forint and 160 million forint provision for closed loans in scope of FX settlement as for those loans which were sold by the Bank before the settlement date the factoring company purchased the loan could reclaim the amount the original borrower might reclaimed from them..

in HUF million	01.01.2017	Allocations	Use	Releases	Reclasssi-fication	Exchange rate changes	31.12.2017

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Provision for guarantees	21,664	3,054	-	(21,090)	-	(68)	3,560
Provision as a precaution	561	20,334	(15,196)	(5,016)	-	(332)	351
Other sundry provisions	2,931	9,287	(3,292)	(4,146)	-	-	4,780
Total	**25,156**	**32,675**	**(18,488)**	**(30,252)**	**-**	**(399)**	**8,691**

in HUF million	01.01.2016	Allocations	Use	Releases	Reclassification	Exchange rate changes	31.12.2016
Provision for guarantees	7,261	15,238	-	(981)	-	146	21,664
Provision as a precaution	611	166	(3)	(208)	(1)	(4)	561
Other sundry provisions	1,974	5,381	(3,691)	(734)	1	-	2,931
Total	**9,846**	**20,785**	**(3,694)**	**(1,923)**	**-**	**142**	**25,156**

26) Other liabilities

in HUF million	2016	2017
Deferred income[1)]	4,791	2,414
Clearing accounts	12,140	9,774
Tax liabilities	1,411	1,575
Other financial liabilities	2,149	1,869
Received payments on advance	1,001	5
Accruals of other expenses	10,125	12,239
Other liabilities	811	2,352
Total	**32,429**	**30,228**

1) Erste Hungary recognises government grant related to the following:

- National Bank of Hungary (NBH) security program

  NBH introduced a floating-rate-payer forint interest rate swap (IRS) facility with terms of three and five years starting from June 2014 and one with a term of ten years starting from July 2015. This facility applies some preferential elements to intensify usage of IRS tenders and also additional purchase of government securities by Banks. Banks are entitled to the preferential element if the government security portfolio is kept at a given level. In 2017 266 million forint (in 2016: 240 million forint) is presented as government grant related to IRS, the deferred income is 318 million forint (in 2016: 584 million forint) .
- NBH SME lending program (PHP)

  NBH introduced a lending activity linked floating-rate-payer forint interest rate swap (HIRS) with terms of one and three years starting from February 2016. Banks are entitled to the preferential gain if criteria combining growth and stability elements related to lending activity in SME sector are met. In 2017 1,548 million forint (in 2016: 1,417 million forint) is presented as government grant related to HIRS, the deferred income is 1,692 million forint (in 2016: 3,240 million forint).

Government grant is presented starting from 2016:

At 1 January 2017	3,824 million forint
Received during the year	0 million forint
Released to the income statement	1,814 million forint
At 31 December 2017	2,010 million forint
At 1 January 2016	824 million forint
Received during the year	4,657 million forint
Released to the income statement	1,657 million forint
At 31 December 2016	3,824 million forint

27) Total equity

in HUF million	2016	2017
Subscribed capital	146,000	146,000
Additional paid-in capital	117,492	117,492
Retained earnings and other reserves	17,523	75,786
Total	**281,015**	**339,278**
Attributable to non-controlling interests	-	-
Attributable to owners of the parent	281,015	339,278

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

As 31 December 2017 subscribed capital amounted to 146,000,000,000 forints (in words: one hundred and forty six billion). The subscribed capital consisted of 146,000,000,000 (in words: one hundred and forty six billion) pieces of dematerialized ordinary shares of 1 forint nominal value each.

Owners of the Bank
As of 31 December 2017, the direct parent of the Bank – owning 70% of the shares – was Erste Group Bank AG, whose registered office at that date was Am Belvedere 1, 1100 Vienna, Austria. The Consolidated Financial Statements of Erste Group are prepared by the ultimate parent of Erste Group 'Erste Group Bank AG', and are available after their completion at the Court of Registry of Vienna, Marxergasse 1a, 1030 Vienna, Austria.

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

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

	31 December 2016		31 December 2017	
Owner	Number of shares	Ownership share	Number of shares	Ownership share
Erste Group Bank AG	102,200,000,000	70%	102,200,000,000	70%
Corvinus Nemzetközi Befektetési Zrt.	21,900,000,000	15%	21,900,000,000	15%
European Bank for Reconstruction and Development	21,900,000,000	15%	21,900,000,000	15%
Total	**146,000,000,000**	**100%**	**146,000,000,000**	**100%**

Retained earnings and other reserves
Within 'Retained earnings and other reserves' the Bank records a 'General Reserve'. Section 83 of the Credit Institutions and Financial Enterprises Act obliges the Bank to allocate 'General Reserve' amounting to 10% of the actual year's profit after tax, as a non-distributable income. Any use of the reserve needs to be in connection to losses on the Bank's core activity. In 2017 the Bank allocated 8,097 million addition reserve to the existing 3,526 million forint general reserve resulting a total general reserve of 11,623 million forint.

28) Segment reporting

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

Retail

The Retail segment is constituted by the branch network where Erste Hungary sells products mainly to private and micro customers (up to 0.7 million euro GDP weighted turnover). The Retail business line at Erste Hungary is divided into 5 regions and 115 branches in 2017 (7 regions and 123 branches in 2016).

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

Corporates

The Corporates segment comprises business done with corporate customers of different turnover size (small and medium-sized enterprises, Local Large Corporate and Group Large Corporate customers) as well as commercial real estate and public sector business. Small and medium-sized enterprises (SME) are clients which are under the responsibility of the local corporate commercial center network, mainly consisting of companies with an annual turnover from EUR 0.7 million to EUR 25 million. The relevant results of workout / property management companies (Erste Ingatlan Kft. and Sió Ingatlan Invest Kft.) are also included into this segment.
Local Large Corporates (LLC) are clients with specific annual turnover thresholds above EUR 25 million to EUR 500 million which are not defined as Group Large Corporate customers according to the Group Large Corporate client list.
Group Large Corporates (GLC) are large corporate customers/client groups with substantial operations in core markets/extended core markets of Erste Group with an indicative consolidated annual turnover of at least EUR 500 million. GLC clients can be found on the GLC client list.
Commercial Real Estate (CRE) covers for example investors in real estate for the purpose of generating income from the rental of individual properties or portfolios of properties, developers of individual properties or portfolios of properties for the purpose of generating capital gains through sale, asset management services. The Commercial Real Estates segment consists of the Erste Hungary Real Estate Business Line and the workout company's relevant results (Erste Ingatlan Kft.).
Public Sector consists of three sets of customers: public sector, public corporations and non-profit sector.

Group Markets (GM)

The Group Markets (GM) segment comprises trading and markets services as well as customer business with financial institutions. It includes all activities related to the trading books of Erste Group, including the execution of trade, market making and short-term liquidity management. In addition, it comprises business connected with servicing financial institutions as clients including custody, depository services, commercial business (loans, cash management, trade & export finance). Besides the Bank's own activities, it also includes institutional clients (typically funds, and asset management companies) at the brokerage company (Erste Befektetési Zrt.)

Asset/Liability Management & Local Corporate Center

The Asset/Liability Management & Local Corporate Center (ALM & LCC) segment comprises on the one side the management of bank assets and liabilities in the light of uncertainty of cash flows, cost of funds and return on investments in order to determine the optimal trade-off between risk, return and liquidity. Furthermore it comprises funding transactions, hedging activities, investments into securities other than held for trading purpose, management of own issues and FX positions.
On the other side it also includes the local corporate center of EBH which comprises all non-core banking business activities such as non-profit servicing participations, intragroup eliminations within EBH partial group, dividends, refinancing costs of participations, all non-banking balance sheet positions (e.g. fixed assets, intangible assets) which cannot be allocated to other business segments as well as the profit and loss positions resulting from these balance sheet items. Apart from that the Corporate Center includes the reconciliations to the accounting result. Besides that the Free Capital of EBH defined as a difference between the average IFRS capital and the sum of the average allocated equity to the operating segments is reported under ALM/Local Corporate Center. The full results of mortgage/refinancing bank company (Erste Jelzálogbank Zrt.) is also included in this segment. The non-allocated

subsidiaries like property management companies' Corporate Centre (Erste Ingatlan Kft., Sió Ingatlan Invest Kft., Collat-Real Kft.) are also recorded in this segment.

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

Business Segments

in HUF million	Retail 2017	Corporates 2017	Group Markets 2017	ALM&LCC 2017	TOTAL 2017
Net interest income	48,530	15,088	3,905	-2,052	65,472
Net fee and commission income	37,621	7,587	4,907	-1,432	48,683
Dividend income	0	0	0	81	81
Net trading result	3,143	3,043	4,513	959	11,658
Result from financial assets and liabilities designated at fair value through profit or loss	0	0	0	-793	-793
Net result from equity method investments	0	0	0	0	0
Rental income from investment properties & other operating leases	0	1,180	0	0	1,180
General administrative expenses	-55,621	-9,511	-3,375	237	-68,269
thereof depreciation and amortization	-7,607	-1,347	-456	-99	-9,509
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	0	0	0	5,753	5,753
Net impairment loss on financial assets	7,634	3,793	-5	-8,618	2,804
Other operating result	-11,565	1,831	-38	3,237	-6,535
Levies on banking activities	-9,637	-3,832	-339	-3,860	-17,668
Pre-tax result from continuing operations	**29,743**	**23,012**	**9,907**	**-2,628**	**60,034**
Taxes on income	-2,427	-812	-615	-1,426	-5,280
Net result for the period	**27,316**	**22,200**	**9,292**	**-4,054**	**54,754**
Net result attributable to non-controlling interests	0	0	0	0	0
Net result attributable to owners of the parent	**27,316**	**22,200**	**9,292**	**-4,054**	**54,754**
Operating income	89,295	26,898	13,324	-3,237	126,280
Operating expenses	-55,621	-9,511	-3,375	237	-68,269
Operating result	**33,674**	**17,387**	**9,950**	**-3,000**	**58,012**
Total assets (eop)	831,915	504,473	210,453	672,228	2,219,069
Total liabilities excluding equity (eop)	961,049	473,537	327,721	117,484	1,879,791
Impairments and risk provisions	**6,501**	**22,112**	**-17**	**-8,865**	**19,731**
Net impairment loss on loans and receivables to credit institutions/customers	7,634	3,793	-5	-8,170	3,252
Net impairment loss on other financial assets	0	0	0	-448	-448
Allocations/releases of provisions for contingent credit risk liabilities	-1,067	19,115	-12	0	18,036
Impairment of goodwill	0	0	0	0	0
Net impairment loss on other non-financial assets	-65	-797	0	-247	-1,109

in HUF million	Retail 2016	Corporates 2016	Group Markets 2016	ALM&LCC 2016	TOTAL 2016
Net interest income	42,700	14,430	5,914	-6,248	56,796
Net fee and commission income	33,443	6,854	4,121	-257	44,161
Dividend income	0	0	0	28	28
Net trading result	2,108	2,759	3,952	-1,741	7,079
Result from financial assets and liabilities designated at fair value through profit or loss	0	0	0	-341	-341
Net result from equity method investments	0	0	0	0	0
Rental income from investment properties & other operating leases	0	1,236	0	0	1,236
General administrative expenses	-48,068	-10,018	-3,224	405	-60,905
thereof depreciation and amortization	-4,752	-1,205	-339	-45	-6,340
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	0	0	41	2,849	2,890
Net impairment loss on financial assets	18,718	10,113	6	-34,134	-5,297
Other operating result	-11,013	-14,897	-187	27,869	1,772
Levies on banking activities	-8,102	-3,771	-406	-6,124	-18,403
Pre-tax result from continuing operations	**37,888**	**10,478**	**10,621**	**-11,568**	**47,420**
Taxes on income	-9,255	-2,815	-2,184	10,177	-4,077
Net result for the period	**28,633**	**7,663**	**8,437**	**-1,390**	**43,343**
Net result attributable to non-controlling interests	0	0	0	0	0
Net result attributable to owners of the parent	**28,633**	**7,663**	**8,437**	**-1,390**	**43,343**
Operating income	78,251	25,280	13,986	-8,557	108,960
Operating expenses	-48,068	-10,018	-3,224	405	-60,905
Operating result	**30,183**	**15,262**	**10,762**	**-8,152**	**48,055**
Total assets (eop)	760,297	401,824	368,203	516,557	2,046,881
Total liabilities excluding equity (eop)	715,168	468,995	474,141	107,562	1,765,865
Impairments and risk provisions	**18,457**	**-5,381**	**6**	**-34,234**	**-21,152**
Net impairment loss on loans and receivables to credit institutions/customers	18,718	10,113	6	-33,825	-4,988
Net impairment loss on other financial assets	0	0	0	-309	-309
Allocations/releases of provisions for contingent credit risk liabilities	-242	-14,016	0	0	-14,257
Impairment of goodwill	0	0	0	0	0
Net impairment loss on other non-financial assets	-19	-1,478	0	-100	-1,597

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

29) Assets and liabilities denominated in foreign currencies

Assets and liabilities not denominated in forint were as follows:

			of which outside Hungary	
in HUF million	**2016**	**2017**	**2016**	**2017**
Assets	**333,098**	**409,782**	**54,919**	**23,900**
EUR	258,303	329,188	21,355	15,695
CHF	20,487	15,986	77	175
USD	51,021	61,806	30,696	5,388
JPY	798	227	545	215
Other	2,489	2,575	2,246	2,427
Liabilities	**595,365**	**532,342**	**72,937**	**72,584**
EUR	505,979	391,634	65,313	64,925
CHF	29,741	6,323	5,452	1,041
USD	50,266	116,050	1,604	5,896
JPY	1,273	1,549	213	3
Other	8,106	16,786	355	719

Further details of the exchange rate open positions in Note 35, page 82.

30) Leases

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

a) Finance leases

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

in HUF million	2016	2017
Outstanding minimum lease payments	33,313	37,678
Non-guaranteed residual values	14,400	-
Gross investment	**47,713**	**37,678**
Unrealised financial income	5,529	2,979
Net investment	**42,184**	**34,699**
Present value of non-guaranteed residual values	14,400	-
Present value of minimum lease payments	**27,784**	**34,699**
Risk provision related to outstanding minimum lease payments	**(1,880)**	**(750)**

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

	Gross investment		Present value of minimum lease payments	
in HUF million	**2016**	**2017**	**2016**	**2017**
< 1 year	7,336	8,405	6,343	7,835
1-5 years	21,710	23,882	15,125	22,404
> 5 years	18,667	5,391	6,316	4,460
Total	**47,713**	**37,678**	**27,784**	**34,699**

b) Operating leases

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

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

Erste Hungary as lessee:

in HUF million	**2016**	**2017**
< 1 year	3,826	4,046
1-5 years	10,238	13,967
> 5 years	7,568	18,618
Total	**21,632**	**36,631**

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

31) Related party transactions

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

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

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Loans and advances and amounts owed to related parties

Loans and advances and amounts owed to related parties		
in HUF million	**2016**	**2017**
Loans and advances to credit institutions[1)]	**38,300**	**7,684**
Parent	38,288	7,676
Fellow subsidiaries	12	8
Loans and advances to customers	**22,853**	**13,167**
Fellow subsidiaries	22,853	13,167
Derivative financial instruments - asset	**8,830**	**14,119**
Parent	7,370	12,885
Fellow subsidiaries	1,460	1,234
Other assets	**3,325**	**3,457**
Parent	3,188	3,130
Fellow subsidiaries	137	327
Deposits by banks	**35,714**	**12,832**
Parent	34,949	11,549
Fellow subsidiaries	765	1,283
Customer deposits	**17,856**	**2,855**
Fellow subsidiaries	17,856	2,855
Derivative financial instruments - liabilities	**6,793**	**8,335**
Parent	6,793	8,335
Other liabilities	**1,563**	**1,809**
Parent	266	553
Fellow subsidiaries	1,297	1,256
Subordinated liabilities	**50,793**	**50,666**
Parent	50,793	50,666

1) Average contractual interest rate:
- 2017: 1.57%
- 2016: 1.44%

Income and expenses to related parties

Income and expenses to related parties		
in HUF million	**2016**	**2017**
Interest Income	**1,716**	**929**
Parent	1,418	769
Fellow subsidiaries	298	160
Interest Expense	**(6,239)**	**(2,425)**
Parent	(6,215)	(2,425)
Fellow subsidiaries	(4)	0
MInority owners	(20)	0
Fee and commission income	**1,196**	**1,404**
Parent	538	565
Fellow subsidiaries	658	839
Fee and commission expense	**(216)**	**(222)**
Parent	(60)	(74)
Fellow subsidiaries	(156)	(148)
Other Income/(Expense)	**216**	**344**
Parent	78	287
Fellow subsidiaries	138	57

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

Management compensation

in HUF million	2016	2017
Fixed salary	371	368
Performance related compensation	265	354
Other compensation	58	59
Total	**694**	**781**

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

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

'Other compensation' includes other contractual allowances.

Contractual and outstanding amounts of loans granted to Board of Directors and Supervisory Board in EBH and subsidiaries are 105.75 and 95.24 million forint in 2017 and 65.6 and 65.13 million forint in 2016, respectively. The average contractual interest rate this loans is 7.44% in 2017 (5.80 % in 2016). Contractual and outstanding amounts of loans granted only in EBH to Board of Directors and Supervisory Board are 8.76 and 8.43 million forint in 2017.

In the year under review, management board members that held office in 2017 received remuneration (including employment related compensation only; severance payments are not included) totalling 781 million forint (in 2016: 694 million forint). 2017 performance related payments are not yet allocated, only budget data are shown.

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

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

These rules are effective from the 2011 performance year.

Breakdown of Supervisory Board and Board of Directors compensation:

in HUF million	2016	2017
Supervisory Board compensation	23	37
Board of Directors compensation	705	804
Total	**728**	**841**

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

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

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The Supervisory Board of the Bank is set-up of three local employee members (who do not receive any payment for their memberships) and six external members who do not have any functional responsibility within the company. In 2017 the external members of the Supervisory Board received a compensation of 37 million forint per year for the membership (in 2016 23 million forint).
The Board of Directors of the Bank is set-up of the members of the managerial board and five external members who do not have managerial responsibility within the company. The external members received a compensation of 24 million forint per year in 2017 (in 2016 12 million forint).

Organization of Erste Bank Hungary Zrt.

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

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

Members of the Board of Directors

The Board of Directors is the managing body of the Bank, which directs the operation, as well as the management of the Bank within the framework of the laws, the Statutes, and the resolutions passed by the General Meeting of the Bank, as well as with taking into consideration the recommendations made by the Supervisory Board.
The Board of Directors consists of 3 (three) members at the minimum. The members of the Board of Directors shall be elected by the General Meeting for a maximum of 5 (five) years. The members of the Board of Directors may be re-appointed and recalled at any time by the General Meeting. Such persons may be elected as members of the Board of Directors who comply with the conditions set out in the Civil Code, the Banking Act, other laws and Erste Bank Hungary Zrt.'s Statutes.

Members of the Supervisory Board

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

The members of the Supervisory Board may be executive officers and Supervisory Board members in other business organizations pursuing – among others – the same activity as the Bank. If such business organization pursuing (among others) the same activity is not a member of Erste Group, the approval of the General Meeting is necessary for holding such position in the other business organisation.
The General Meeting shall elect the chairman of the Supervisory Board from its members.
The Chairman of the Supervisory Board may be invited to the meetings of the Board of Directors with consultation rights.

Members of the Remuneration and Nomination Committee

The members of the Committee shall be 3 (three) delegated person from the external members of the Board of Directors.
The chairman of the Committee is elected by the Committee itself from the members of the Committee.

Members of the Risk Governance Committee

The members of the Committee shall be 3 (three) delegated person from the external members of the Board of Directors.
The Risk Governance Committee elects the chairman of the Committee from among the members of the Committee.

Members of the Managing Board

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

32) Collateral

The following assets were pledged as security for liabilities:

in HUF million	2016	2017
Loans and receivables to credit institutions and customers	99,446	278,653
Financial assets - held for trading	2,489	1,682
Financial assets - available for sale	36,247	15,094
Financial assets - held to maturity	61,659	51,949
Total	**199,841**	**347,378**

The financial assets pledged as collateral consist of loan receivables, bonds and other interest-bearing securities.
Collaterals were pledged as a result of repo, refinancing, derivative and card transactions.
Loans and receivables to customers contain SME loans for a refinancing program with the National bank of Hungary, of 10,203 million forint (16,254 million forint in 2016). Details of the program see in Note 9, Other operating result table, comment 2), page 34.
This category also contains encumbered deposits placed for derivative and card transactions.

33) Securities lending and repurchase transactions

	2016		2017	
in HUF million	Carrying amount of transferred assets	Carrying amount of associated liabilities	Carrying amount of transferred assets	Carrying amount of associated liabilities
Securities lending	**1,652**	**-**	**-**	**-**
Financial assets - held for trading	1,652	-	-	-
Repurchase agreements	**-**	**-**	**1,614**	**1,654**
Financial assets - held for trading	-	-	-	-
Financial assets - available for sale	-	-	346	347
Financial assets - held to maturity	-	-	1,268	1,307
Total	**1,652**	**-**	**1,614**	**1,654**

	2016			2017		
in HUF million	Fair value of transferred assets	Fair value of associated liabilities	Net position	Fair value of transferred assets	Fair value of associated liabilities	Net position
Securities lending	**1,652**	-	**1,652**	-	-	-
Financial assets - held for trading	1,652	-	1,652	-	-	-
Repurchase agreements	-	-	-	**1,634**	**1,654**	**(20)**
Financial assets - held for trading	-	-	-	-	-	-
Financial assets - available for sale	-	-	-	346	347	(1)
Financial assets - held to maturity	-	-	-	1,288	1,307	(19)
Total	**1,652**	**-**	**1,652**	**1,634**	**1,654**	**(20)**

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

34) Off-setting

The below tables include once all the repurchased agreements, twice all the derivatives deals where ISDA agreement provides the potential for offsetting.

Financial assets subject to offsetting and potential offsetting agreements in 2017

in HUF million	Gross amounts in Statement of Financial Position	Amounts set off against financial liabilities	Net amounts in Statement of Financial Position	Potential effects of netting agreements not qualifying for offsetting in Statement of Financial Position			Net amount after potential offsetting
				Financial instruments	Cash collateral received	Non-cash financial collateral received	
Derivatives	21,083	-	21,083	8,612	-	-	12,471
Reverse repurchase agreements	-	-	-	-	-	-	-
Total	**21,083**	**-**	**21,083**	**8,612**	**-**	**-**	**12,471**

Liabilities subject to offsetting and potential offsetting agreements 2017

in HUF million	Gross amounts in Statement of Financial Position	Amounts off against financial assets	Net amounts in Statement of Financial Position	Potential effects of netting agreements not qualifying for offsetting in Statement of Financial Position			Net amount after potential offsetting
				Financial instruments	Cash collateral pledged	Non-cash financial collateral pledged	
Derivatives	15,092	-	15,092	8,612	-	-	7,369
Repurchase agreements	1,654	-	1,654	-	-	1,634	20
Total	**16,746**	**-**	**16,746**	**8,612**	**-**	**1,634**	**7,389**

Financial assets subject to offsetting and potential offsetting agreements in 2016

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

Liabilities subject to offsetting and potential offsetting agreements 2016

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

35) Risk management

35.1. Risk Management Principles

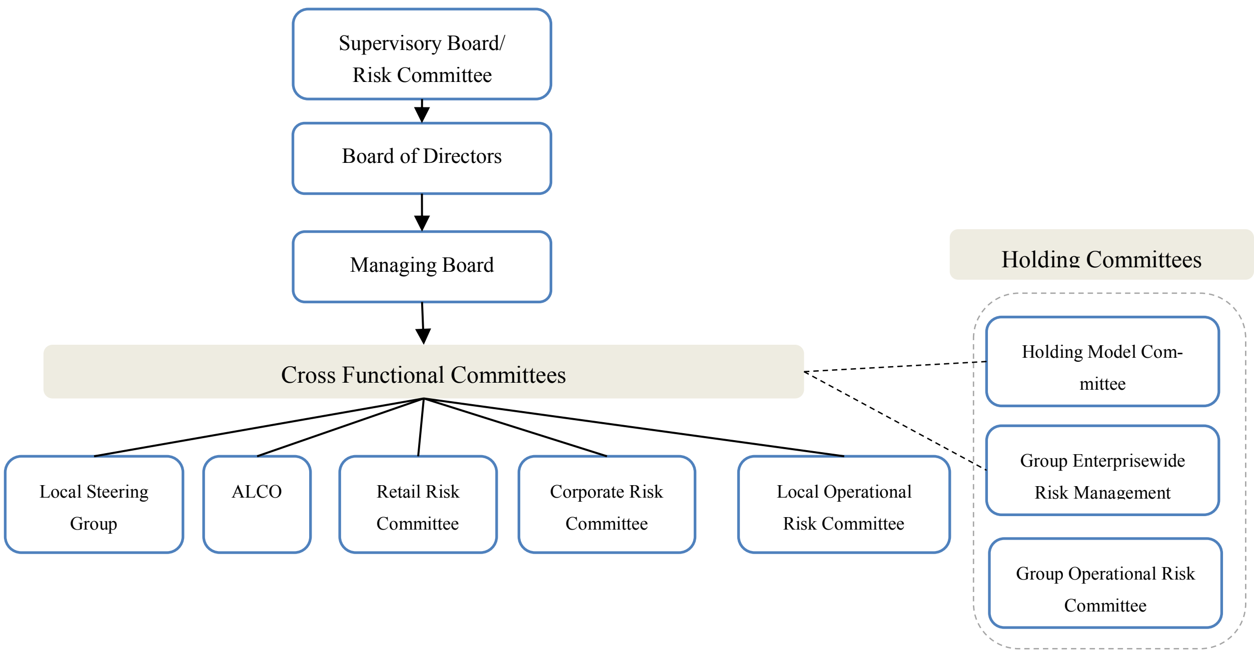
Erste Hungary naturally takes risk in connection with its business and as such following principles underpin risk management in the institution:

- Erste Hungary's Chief Risk Officer ("CRO") is accountable for developing the Risk Strategy Framework and ensures that the components of the Framework are well defined. Risk Strategy Framework is signed off by Managing Board, Board of Directors while Supervisory Board's Risk Committee ensures control over the Risk Strategy Framework (i.e. key principles, compliance to the group strategy, and regularly reviews the status on the individual components).
- Risk Appetite Statement as one of the cornerstones of Risk Strategy Framework is set in conjunction with the business and capital/liquidity strategy covers mid-term horizon (usually 5 years' timeframe). Risk Appetite Statement is valid until withdrawn, and reviewed once a year prior to planning process, validated during the planning process, signed off by the management together with the final business plan.
- Enterprise-wide Risk Management ("ERM") Framework provides the processes, controls, and toolkits to carry out regular review of internal capital adequacy assessment, including the regular RAS monitoring process.
- CRO is accountable for aggregating the risks that Erste Hungary is exposed to, to manage effective reporting systems and overall to deliver and submit a holistic view on all risks types to the management. Timely and transparent reporting system must be established with continuous assessment of risks and exceptional cases shall be reported immediately.
- Monitoring and back-testing over operation of risk management methodologies and models must be ensured. This means to have a regular structured assessment process, which validates accuracy and relevancy of the models, reviews the implemented processes of use.
- The detailed provisions and requirements necessary to comply with the Risk Strategy Framework shall be described in lower level risk policies, guidelines and operational working instruction according to the structure of Risk Policy Framework for all risk types arising from the risk taking activities.
- Roles and responsibilities were separated in line with the "three lines of defence model" and shall be clearly defined within the organization. That is business units within the Bank (i.e. units taking risk) and risk management units (i.e. units assessing, controlling and monitoring the risk) shall be separated from each other organizationally and in terms of the responsibilities up to the level of Managing Board. Respective risk management activities shall be audited and evaluated by the independently functioning Internal Audit, and should be overseen and verified by the Supervisory Board.
- Erste Hungary ensured risk mitigation action and an adequate capital level which shall cover minimum level of risks planned in a course of business and risk strategy, and shall cover the buffer set aside for the exceptional but plausible events, as a result of the stress tests.
- Erste Hungary has in place an internally approved and well-documented "new product approval policy" which addresses not only the development and approval of entirely new products but also significant changes in the features of existing products.
- The management and employees who perform risk related tasks under risk management must possess the knowledge and experience needed for their particular tasks. In addition the Bank ensured an enforcement of risk culture throughout the entire organisation.
- Risk management principles, methodologies, measurements and process must be in line with the Group standards and Hungarian supervisory requirements.

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

35.2. Risk management organisation

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



Overview of Risk Management Structure

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

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

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

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

Corporate 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 corporate's, 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 the market risk area. Corporate Risk Management is responsible for also solving problem credits in area of corporate and municipal customers. It has restructuring and workout of arms dealing with different levels problem clients.

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

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

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

Coordination of Risk Management Activities

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

- Risk Governance Committee, which is a sub-committee of the Supervisory Board of Erste Hungary, is the most senior risk committee in Erste Hungary. It is responsible for the approval of methods and processes of risk control and management as well as for the risk infra-structure. The Risk Governance Committee also monitors the capital base and allocates capital at the macro level and determines the risk framework. As the central risk control body, the Risk Governance Committee is frequently and regularly briefed on the risk status, both retrospectively and prospectively, and across all risk types. The Risk Governance Committee analyses the current status as well as any trends and makes management decisions at the highest level. In line with the new Hungarian Banking Act (Act CCXXXVII of 2013.) valid from 1th of January 2014 EBH has established the Risk Governance Committee, thus EBH has terminate the Risk Committee as a subcommittee of the Supervisory Board and established a new, independent Risk Governance Committee. The new Risk Governance Committee is the successor of the former Risk Committee, but with the new duties and composition defined by the new Banking Act. which operates stringing from January 2014
- Operating Liquidity Committee ("OLC"), as a sub-committee of the ALCO, is responsible for the day-to-day management of the liquidity position of Erste Hungary. It analyses the liquidity situation of Erste Hungary on a regular basis and reports directly to the Asset Liability Committee ("ALCO"). It also proposes measures to the ALCO within the scope of the management policies and principles laid down in the Liquidity Risk Management Rule Book. Furthermore, members of the OLC are points of contact

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for other departments or Erste Hungary members for liquidity-related matters. For additional information on the ALCO, see "Liquidity Risk - Organisation and reporting".

- Retail Risk Committee (hereafter RRC) is responsible for continuous supervision and decision over of the Bank's retail risk taking rules, limits and risk parameters. The RRC is informed about the Risk Appetite statement of the management and responsible to develop and decide on retail risk strategy which derived from the risk tolerance. The RRC contributes to the internal capital assessment process.
- Corporate Risk Committee (hereafter CRC) is responsible for continuous supervision and decision over of the Bank's corporate risk taking rules, limits and risk parameters. The CRC is informed about the Risk Appetite statement of the management and responsible to develop and decide on corporate risk strategy which derived from the risk tolerance. The CRC contributes to the internal capital assessment process. The CRC is the forum of discussions and decisions on new business initiatives, on application of new tools, systems or procedures in business and in risk management, on regular reports about the high priority business and risk projects in corporate banking area.
- Corporate Credit Committee ("CC") is the main steering body for corporate credit risk related operations in Erste Hungary. The CC informs the Managing Board about the decisions it is taking on a monthly basis.
- Local Operational Risk Committee ("LORCO") approves and follows up risk mitigating measures arising from Operational Risk activities. The LORCO operates on a quarterly basis.

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

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

35.3. Risk Control

Overview of Risk Control Governance Structure

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

Enterprise-wide Risk Management (ERM) which is a sub-unit of Strategic Risk Management plays a role in monitoring and aggregating the portfolio risk against the appetite level articulated in the Risk Appetite Statement of the institution. Objectives of the unit are

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

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

Risk control process

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

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

Risk measurement methods

Having passed the required audit conducted by the Hungarian supervisory authority in 2008, Erste Hungary successfully qualified for Internal Ratings Based (IRB) approach to the measurement of credit risk in accordance with the Part Three – Title II - Chapter 3 of Capital Requirement Regulation – (CRR - Regulation EU No 575/2013). For credit risk, Erste Hungary applies the Advanced IRB Approach in the retail segment and the Foundation IRB Approach in all other material exposures classes. Standardized approach is used permanently for sovereign exposures, exposures against subsidiaries and immaterial portfolio elements.
Under Pillar 2 EBH applies internally estimated LGD parameters for material exposures classes which indicate a more risk sensitive risk measurement under ICAAP framework.

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

For the market risk exposures in trading book Erste Hungary uses the Standardised Approach.

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

35.4. Risk and capital management

Overview

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

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

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

Risk Strategy and Risk Appetite

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

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

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

Portfolio and Risk Analytics

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

Risk Materiality Assessment

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

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

Risk Modelling and Stress Testing

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

Risk-bearing Capacity Calculation

Within the Risk-bearing Capacity Calculation, Erste Hungary's material risks are compared to the capital/coverage potential according to Internal Capital Adequacy Assessment Process (ICAAP) standards. The quarterly capital adequacy calculation undertaken by

Erste Hungary serves not only as a tool to assess the actual capital adequacy of the group but also to provide a forward-looking picture, make recommendations and start taking actions as may be necessary for a sustainable sound capitalisation.

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

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

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

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

Risk Planning and Forecasting

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

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

Risk exposure management

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

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

Capital allocation

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

35.5. Recovery plan

The Hungarian Supervisor required the Hungarian banks, including Erste Bank Hungary to develop a recovery plan in line with the European Banking Authority (EBA) and National Bank of Hungary (MNB) recommendations. Erste Bank Hungary submitted the first version of its recovery plan in October 2013 and the detailed documentation in February 2014. Institutions required to prepare a recovery plan have to update it on a yearly basis, the latest updated version reflecting recent development of the economic environment in which Erste Bank Hungary operates was submitted in September 2017. Erste Bank Hungary Recovery Plan 2017 describes

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the governance structure serving development and regular update of Erste Hungary's recovery plan, the potential stresses jeopardising the capital or liquidity position of the Erste Hungary as well as the possible measures, in quantified form, to maintain or restore stable financial positions if it is necessary.

35.6. Credit risk

Definition and overview

Credit risk arises in Erste Hungary's traditional lending business, comprising losses incurred as a result of default by the borrowers or by the need to set aside provisions as a result of the deteriorating credit quality of certain borrowers, as well as from trading in market risk instruments (counterparty risk). Operative credit decisions are made by the operative risk management unit, see also for a detailed explanation in the chapter of the role and responsibilities.

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

Internal rating system

Overview

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

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

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

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

Internal Rating models and risk parameters are developed by internal teams of specialists. Rating development follows internal methodology formalised into an Erste Group wide methodology and documentation standard (White Paper). Rating models are developed based on relevant and most accurate data covering always the respective market. In such a way Erste Hungary established highly predictive rating models.

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

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

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

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

- **Low risk:** Typically regional customers with well-established and rather long-standing relationships with Erste Group or large internationally recognised customers. Very good to satisfactory financial position and low likelihood of financial difficulties relative to the respective market in which the customers operate. Retail clients having long relationships with the bank, or clients with a wide product pool use. No relevant late payments currently or in the most recent 12 months. New business is generally done with clients in this risk category.
- **Management attention:** Vulnerable non-retail clients that may have overdue payments or defaults in their credit history or may encounter debt repayment difficulties in the medium term. Retail clients with possible payment problems in the past triggering early collection reminders. These clients typically have a good recent payment history
- **Substandard:** The borrower is vulnerable to short term negative financial and economic developments and shows an elevated probability of failure. In some cases, restructuring measures are possible or already in place. As a rule, such loans are managed in specialised risk management departments.
- **Non-performing:** One or more of the default criteria under Article 178 of the CRR are met: among others, 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. As from 2015, Erste Bank applies the customer view for all customer segments, including retail clients; if an obligor defaults on one deal then the customer's performing transactions are classified as non-performing as well. Furthermore, non-performing exposures also comprise non-performing forborne transactions even in cases where the client has not defaulted.

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

Impairment assessment

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

Credit risk provisions are calculated:

- for financial assets carried at amortised cost (loans and receivables, financial assets held to maturity) in accordance with IAS 39 and
- for contingent liabilities (financial guarantees, loan commitments) in accordance with IAS 37.

Credit risk provisions are created in a process performed on customer level. The process includes the identification of default and impairment and the type of assessment (individual or collective) to be applied. 'On customer level' means in this context that if one of the customer's exposures is classified as defaulted, typically all of this customer's exposures are classified as defaulted. Depending on the characteristics of the exposure and the respective expected cash flows (e.g. considering collateral), some exposures may not be impaired.
The bank distinguishes between two types of allowances:

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- specific allowances calculated for exposures to defaulted customers that are deemed to be impaired and
- collective allowances (allowances for incurred but not reported losses) calculated for exposures to non-defaulted customers or defaulted customers that are not deemed to be impaired.

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

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

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

Collective allowances are also calculated in case of exposures to defaulted customers that are not identified as impaired. For these customers, no specific allowances are allocated. Collective allowances are calculated based on the historical loss experience for the relevant customer segment.

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

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

Materiality threshold

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

Credit Risk Review and Monitoring

Credit Monitoring

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

Portfolio reports for asset classes and business lines are prepared on regular basis Watch-list meetings or remedial committee meetings are held on a regular basis to discuss customers with weak ratings or to discuss preventive measures to help a particular client avoid default.
For retail business, Retail Risk and Workout Management is responsible to undertake these monitoring activities and fulfil the minimum requirements of Erste Hungary retail risk.

Credit Exposure

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

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

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

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

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

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

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

Analysis of risk concentration

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

Credit exposure (gross carrying amount) by industry 2017

	Cash and cash balances – other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Financial assets - held to maturity	Debt securities Finan-cial assets - held for trading	Financial assets - at fair value through profit or loss	Finan-cial assets - available for sale	Positive fair value of derivatives	Contingent liabilities	Total credit risk exposure
in HUF million			At amortised cost			At fair value				
As of 31 December 2017										
Agriculture and forestry	-	-	34,483	-	-	-	-	0	487	34,970
Mining	-	-	12,234	-	-	-	-	-	687	12,921
Manufacturing	-	-	124,782	-	-	-	-	235	81,029	206,046
Energy and water supply	-	-	13,707	-	-	-	-	21	6,480	20,208
Construction	-	-	6,389	-	-	-	-	1	9,153	15,544
Development of buil-ding projects	-	-	-	-	-	-	-	-	-	-
Trade	-	-	56,938	-	-	-	-	98	9,963	66,999
Transport and communication	-	-	31,325	-	-	-	-	1,734	1,149	34,208
Hotels and restaurants	-	-	10,296	-	-	-	-	-	1,352	11,648
Financial and insurance services	1,031	68,672	19,279	68,544	31,100	-	-	15,568	16,143	220,340
Holding companies	-	-	-	-	-	-	-	-	-	-
Real estate and housing	-	-	150,204	-	-	-	-	2,022	36,509	188,734
Services	-	-	42,031	-	-	-	-	1,391	2,334	45,757
Public administration	-	-	3,824	583,356	91,522	-	136,765	-	30,000	845,467
Education, health and art	-	-	3,310	-	-	-	-	-	35	3,344
Private households	-	-	673,195	-	-	-	-	-	104,611	777,806
Other	-	-	0	-	-	-	-	12	-	12
Total	**1,031**	**68,672**	**1,181,997**	**651,900**	**122,622**	**-**	**136,765**	**21,083**	**299,933**	**2,484,003**

Credit exposure (gross carrying amount) by industry 2016

in HUF million	Cash and cash balances – other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Financial assets - held to maturity	Financial assets - held for trading	Financial assets - at fair value through profit or loss	Financial assets - available for sale	Positive fair value of derivatives	Contingent liabilities	Total credit risk exposure
					Debt securities					
	At amortised cost				At fair value					
As of 31 December 2016										
Agriculture and forestry	-	-	27,481	-	-	-	-	7	649	28,138
Mining	-	-	12,537	-	-	-	-	-	807	13,344
Manufacturing	-	-	73,898	-	6	-	-	790	56,477	131,172
Energy and water supply	-	-	9,186	-	258	-	-	55	2,217	11,716
Construction	-	-	5,424	-	-	-	-	-	6,720	12,144
Development of building projects	-	-	-	-	-	-	-	-	-	-
Trade	-	-	49,200	-	-	-	-	21	9,123	58,343
Transport and communication	-	-	21,371	-	26	-	-	9	359	21,766
Hotels and restaurants	-	-	11,793	-	-	-	-	-	78	11,871
Financial and insurance services	11,048	145,499	6,558	4,526	434	-	26,614	10,498	47	205,225
Holding companies	-	-	-	-	-	-	-	-	-	-
Real estate and housing	-	-	169,182	-	-	-	-	2,869	24,294	196,345
Services	-	-	34,413	-	-	-	-	1,149	1,551	37,113
Public administration	-	-	1,369	432,142	116,055	-	110,356	-	60,000	719,923
Education, health and art	-	-	2,953	-	879	-	-	-	3	3,835
Private households	-	-	673,964	-	-	-	-	-	29,632	703,596
Other	-	-	1,104	-	-	-	779	-	-	1,883
Total	**11,048**	**145,499**	**1,100,435**	**436,668**	**117,658**	**-**	**137,749**	**15,397**	**191,958**	**2,156,413**

Credit Exposure (gross carrying amount) by Risk Category

The following table presents the total credit risk exposure (gross carrying amount) of Erste Hungary by risk category as of 31 December 2017.

Credit Exposure (gross carrying amount) by Risk Category

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
Credit risk exposure December 2017	2,240,680	144,139	32,480	66,704	2,484,003
Share of credit risk exposure	90.2%	5.8%	1.3%	2.7%	100.0%
Credit risk exposure December 2016	1,827,373	171,846	34,472	122,722	2,156,413
Share of credit risk exposure	84.7%	8.0%	1.6%	5.7%	100.0%
Change in credit risk exposure in 2017	413,307	(27,707)	(1,992)	(56,018)	327,590
Change	22.6%	-16.1%	-5.8%	-45.6%	15.2%

In 2017 the portfolio quality improvement continued. In Corporate segment closing of big ticket size non-performing loans amounted 38 billion. alongside with upgrade of 5 billion; while new default was 2.3 billion. In the Retail segment non-performing exposure decreased by 16 billion driven by upgrades and cooperative exits. The significant increase in low risk category driven by strong new lending activity in Corporate segment and acquisition of Citi Portfolio.

Credit Exposure by Industry and Risk Category

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

Credit exposure by industry and risk category in 2017

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
As of 31 December 2017					
Agriculture and forestry	26,958	7,590	2	421	34,970
Mining	12,357	564	0	-	12,921
Manufacturing	189,941	15,068	286	751	206,046
Energy and water supply	15,050	2,159	1,116	1,884	20,208
Construction	12,316	3,069	9	150	15,544
Development of building projects	-	-	-	-	-
Trade	58,366	7,218	157	1,258	66,999
Transport and communication	31,348	2,633	40	187	34,208
Hotels and restaurants	10,480	668	450	50	11,648
Financial and insurance services	220,335	4	-	1	220,340
Holding companies	-	-	-	-	-
Real estate and housing	161,109	9,431	14,732	3,463	188,734
Services	42,405	2,859	117	375	45,757
Public administration	845,273	11	0	181	845,466
Education, health and art	908	1,024	1,411	1	3,344
Private households	613,832	91,830	14,161	57,982	777,805
Other	0	12	-	0	12
Total	**2,240,678**	**144,140**	**32,481**	**66,704**	**2,484,003**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total credit risk exposure
As of 31 December 2016					
Agriculture and forestry	20,385	7,533	2	219	28,138
Mining	12,809	534	1	-	13,344
Manufacturing	117,908	9,368	407	3,488	131,172
Energy and water supply	7,755	154	1	3,806	11,716
Construction	8,966	2,802	26	350	12,144
Development of building projects	-	-	-	-	-
Trade	47,018	9,340	193	1,792	58,343
Transport and communication	16,759	4,221	35	751	21,766
Hotels and restaurants	10,635	575	529	132	11,871
Financial and insurance services	190,149	15,014	-	62	205,225
Holding companies	-	-	-	-	-
Real estate and housing	129,422	15,054	13,567	38,302	196,345
Services	29,877	5,457	185	1,594	37,113
Public administration	719,088	0	-	834	719,923
Education, health and art	1,631	555	1,592	57	3,835
Private households	513,149	101,236	17,935	71,276	703,596
Other	1,820	5	-	58	1,883
Total	**1,827,373**	**171,846**	**34,472**	**122,722**	**2,156,413**

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

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

Credit Exposure of loans and receivables to customers (gross carrying amount) by business segment and risk category in 2017

in HUF million	Low risk	Management attention	Substandard	Non-performing	Credit risk exposure
As of 31 December 2017					
Retail	758,021	92,558	14,459	58,614	923,652
Corporates	604,274	48,734	18,021	8,090	679,119
Group Markets	865,384	22	-	0	865,406
Asset/Liability Management and Local Corporate Center	13,001	2,825	-	-	15,826
Savings Banks	-	-	-	-	-
Group Corporate Center	-	-	-	-	-
Total	**2,240,680**	**144,139**	**32,480**	**66,704**	**2,484,003**

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

in HUF million	Low risk	Management attention	Substandard	Non-performing	Credit risk exposure
As of 31 December 2016					
Retail	577,746	101,779	18,396	71,967	769,888
Corporates	452,875	55,033	16,076	50,687	574,670
Group Markets	796,743	15,035	-	67	811,845
Asset/Liability Management and Local Corporate Center	9	-	-	-	9
Savings Banks	-	-	-	-	-
Group Corporate Center	-	-	-	-	-
Total	**1,827,373**	**171,846**	**34,472**	**122,722**	**2,156,413**

Non-performing loans and receivables to customers by business segment and coverage by loan loss allowances and collateral 2017

in HUF million	Non-performing	Gross customer loans	Allowances for customer loans	Specific allowances	Collective allowances	NPL ratio	NPL coverage ratio (excl. collateral)	Collateral for NPL	NPL total coverage ratio
As of 31 December 2017									
Retail	56,825	681,388	43,998	34,510	9,488	8.3%	77.4%	34,008	137.3%
Corporates	7,987	494,993	14,298	4,346	9,953	1.6%	179.0%	3,746	225.9%
Group Markets	0	5,616	4	0	4	0.0%	6989.1%	-	6989.1%
Asset/Liability Management and Local Corporate Center	-	0	-	-	-	0.0%		-	
Savings Banks	-	-	-	-	-			-	
Group Corporate Center	-	-	-	-	-			-	
Total	**64,812**	**1,181,997**	**58,300**	**38,856**	**19,444**	**5.5%**	**90.0%**	**37,754**	**148.2%**

Non-performing loans and receivables to customers by business segment and coverage by loan loss allowances and collateral 2016

in HUF million	Non-performing	Gross customer loans	Allowances for customer loans	Specific allowances	Collective allowances	NPL ratio	NPL coverage ratio (excl. collateral)	Collateral for NPL	NPL total coverage ratio
As of 31 December 2016									
Retail	71,108	682,451	49,630	42,068	7,562	10.4%	69.8%	45,625	134.0%
Corporates	33,925	404,715	29,561	20,859	8,702	8.4%	87.1%	9,362	114.7%
Group Markets	8	13,259	12	8	4	0.1%	152.3%	-	152.3%
Asset/Liability Management and Local Corporate Center	-	9	0	-	0	0.0%		-	
Savings Banks	-	-	-	-	-			-	
Group Corporate Center	-	-	-	-	-			-	
Total	**105,041**	**1,100,435**	**79,203**	**62,935**	**16,269**	**9.5%**	**75.4%**	**54,986**	**127.7%**

Restructuring, renegotiation and forbearance

Restructuring means contractual modification of any of the customer's loan repayment conditions including tenor, interest rate, fees, principal amount due or a combination thereof. Restructuring can be business restructuring (in the retail segment), commercial renegotiation (in the corporate segment), or forbearance (e.g. concession due to financial difficulties) in line with EBA requirements in both segments.

Business restructuring and renegotiation

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

Forbearance

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

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

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

Concession means that any of the following conditions are met:

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

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

Forbearance measures are divided and reported as:
_ Performing forbearance (incl. performing forbearance under probation that was upgraded from non-performing forbearance)
_ Non-performing forbearance (incl. non-performing forbearance and defaulted/impaired forbearance)

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

Performing forborne exposures become non-performing when during the monitoring period of a minimum of 2 years following forbearance classification
_ an additional forbearance measure is extended and in the past the customer was in the non-performing forbearance category or
_ the customer becomes more than 30 days past due on forborne exposure and in the past the customer was in the non-performing forbearance category or
_ the customer meets any of the default event criteria defined in Erste Group's internal default definition

The performing forbearance classification can be discontinued and the account can become a non-forborne account when all of the following conditions are met:
_ a minimum of 2 years have passed from the date of classifying the exposure as performing forbearance (probation period);
_ under the forborne payment plan, at least 50% of the original (pre-forbearance) instalment has been regularly repaid at least during half of the probation period (in the case of retail customers) or
_ regular repayments in a significant amount during at least half of the probation period have been made (in the case of corporate customers);
_ none of the exposure of the customer is more than 30 days past due at the end of the probation period.

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

In the corporate segment, recognition of forbearance measures typically leads to the involvement of the responsible local workout unit. The largest part of the forbearance measures is set within the responsibility of the local workout units and the affected clients are managed and monitored according to the internal regulations and standards for the workout involvement. Forbearance measures are defined as trigger events for carrying out impairment tests according to the internal regulations and standards based on the IFRS requirements.
Forbearance rules were implemented for the bank in 2015. For 2014 the Bank considered restructured cases as forborne, if they were in default at the time of restructuring or overdue with more than 30 days after restructuring.

Gross forborne exposures 2017

As of 31 December 2017	Gross forborne exposure	Modification in terms and conditions	Refinancing
Loans and advances excl. Financial assets - held for trading	20,808	19,909	899
Debt Instruments excl. Financial assets - held for trading	1,115	1,115	-
Loan committments	36	36	-
Total	**21,959**	**21,060**	**899**

Gross forborne exposures 2016

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

Credit quality of forbearance exposure

in HUF million	Gross forborne exposure	Neither past due nor impaired	Past due but not impaired	Impaired	Collateral	Credit risk provision
As of 31 December 2017	21,959	11,414	2,370	8,175	10,478	5,570
As of 31 December 2016	44,032	23,601	2,564	17,867	14,899	14,696

Credit risk exposure by business segment and collateral December 2017

in HUF million	Total credit risk exposure	Collateral total	Collateralised by Guarantees	Collateralised by Real estate	Collateralised by Other	Credit risk exposure net of collateral
As of 31 December 2017						
Retail	923,651	398,245	2,795	379,036	16,413	525,406
Corporates	679,119	236,820	43,782	118,668	74,371	442,299
Group Markets	865,407	9,959	6,185	37	3,737	855,448
Asset/Liability Management and Local Corporate Center	15,826	-	-	-	-	15,826
Savings Banks	-	-	-	-	-	-
Group Corporate Center	-	-	-	-	-	-
Total	**2,484,003**	**645,024**	**52,762**	**497,741**	**94,521**	**1,838,979**

Credit risk exposure by business segment and collateral December 2016

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

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

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Credit risk exposure by financial instrument and collateral 2017

in HUF million	Total credit risk exposure	Collateral total	Collateralised by Guarantees	Real estate	Other	Credit risk exposure net of collateral	Neither past due nor impaired	Past due but not impaired	Impaired
As of 31 December 2017									
Cash and cash balances – other demand deposits	1,031	-	-	-	-	1,031	1,031	-	-
Loans and receivables to credit institutions	68,674	3,739	-	-	3,739	64,934	68,659	15	-
Loans and receivables to customers	1,181,996	595,176	21,415	489,244	84,517	586,821	1,051,512	71,412	59,072
Financial assets - held to maturity	651,900	-	-	-	-	651,899	651,900	-	-
Financial assets - held for trading	122,622	-	-	-	-	122,622	122,622	-	-
Financial assets - at fair value through profit or loss	-	-	-	-	-	-	-	-	-
Financial assets - available for sale	136,765	-	-	-	-	136,765	136,765	-	-
Positive fair value of derivatives	21,083	-	-	-	-	21,083	21,083	-	-
Contingent liabilities	299,932	46,109	31,347	8,497	6,265	253,824	277,104	20,979	1,849
Total	**2,484,003**	**645,024**	**52,762**	**497,741**	**94,521**	**1,838,979**	**2,330,676**	**92,406**	**60,921**

Credit risk exposure by financial instrument and collateral 2016

in HUF million	Total credit risk exposure	Collateral total	Collateralised by Guarantees	Real estate	Other	Credit risk exposure net of collateral	Neither past due nor impaired	Past due but not impaired	Impaired
Cash and cash balances – other demand deposits	11,048	-	-	-	-	11,048	11,048	-	-
Loans and receivables to credit institutions	145,501	16	0	-	16	145,485	145,421	21	59
Loans and receivables to customers	1,100,440	597,908	15,674	484,463	97,771	502,533	935,184	66,140	99,116
Financial assets - held to maturity	436,668	-	-	-	-	436,668	436,668	-	-
Financial assets - held for trading	117,652	-	-	-	-	117,651	117,652	-	-
Financial assets - at fair value through profit or loss	-	-	-	-	-	-	-	-	-
Financial assets - available for sale	137,749	-	-	-	-	137,749	137,749	-	-
Positive fair value of derivatives	15,397	-	-	-	-	15,397	15,341	-	56
Contingent liabilities	191,958	71,001	61,321	4,964	4,716	120,957	173,411	995	17,552
Total	**2,156,413**	**668,925**	**76,995**	**489,427**	**102,503**	**1,487,488**	**1,972,474**	**67,156**	**116,783**

Credit risk exposure past due and not covered by specific allowances by financial instrument and collateralisation 2017

in HUF million	Total credit risk exposure: Total	Thereof 1-30 days	Thereof 31-60 days	Thereof 61-90 days	Thereof 91-180 days	Thereof more than 180 days	Thereof collateralised: Total	Thereof 1-30 days	Thereof 31-60 days	Thereof 61-90 days	Thereof 91-180 days	Thereof more than 180 days

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		past due	past due	past due	past due	past due		past due	past due	past due	past due	past due
As of 31 December 2017												
Cash and cash balances – other demand deposits	-	-	-	-	-	-	-	-	-	-	-	-
Loans and receivables to credit institutions	15	2	-	-	-	13	2	2	-	-	-	-
Loans and receivables to customers	71,412	57,135	5,569	2,221	189	6,298	30,388	26,486	2,751	692	35	423
Financial assets - held to maturity	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets - held for trading	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets - at fair value through profit or loss	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets - available for sale	-	-	-	-	-	-	-	-	-	-	-	-
Positive fair value of derivatives	-	-	-	-	-	-	-	-	-	-	-	-
Contingent liabilities	20,979	20,589	289	36	40	25	-	-	-	-	-	-
Total	**92,406**	**77,725**	**5,858**	**2,257**	**229**	**6,336**	**30,390**	**26,488**	**2,751**	**692**	**35**	**423**

Credit risk exposure past due and not covered by specific allowances by financial instrument and collateralisation 2016

	Total credit risk exposure						Thereof collateralised					
in HUF million	**Total**	**Thereof 1-30 days past due**	**Thereof 31-60 days past due**	**Thereof 61-90 days past due**	**Thereof 91-180 days past due**	**Thereof more than 180 days past due**	**Total**	**Thereof 1-30 days past due**	**Thereof 31-60 days past due**	**Thereof 61-90 days past due**	**Thereof 91-180 days past due**	**Thereof more than 180 days past due**
As of 31 December 2016												
Cash and cash balances – other demand deposits	-	-	-	-	-	-	-	-	-	-	-	-
Loans and receivables to credit institutions	21	-	-	-	-	21	-	-	-	-	-	-
Loans and receivables to customers	66,140	48,333	7,509	2,200	295	7,801	31,013	25,555	4,056	1,107	41	253
Financial assets - held to maturity	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets - held for trading	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets - at fair value through profit or loss	-	-	-	-	-	-	-	-	-	-	-	-
Financial assets - available for sale	-	-	-	-	-	-	-	-	-	-	-	-
Positive fair value of derivatives	-	-	-	-	-	-	-	-	-	-	-	-
Contingent liabilities	77	-	63	6	3	4	170	170	-	-	-	-
Total	**66,237**	**48,333**	**7,572**	**2,207**	**299**	**7,826**	**31,183**	**25,725**	**4,056**	**1,107**	**41**	**253**

Credit risk exposure by Basel 3 exposure class and financial instrument December 2017

				Debt securities						
	Cash and cash balances – other	**Loans and receivables to credit institutions**	**Loans and receivables to customers**	**Financial assets - held to maturity**	**Financial assets - held for trading**	**Financial assets - at fair value through**	**Financial assets - available for sale**	**Positive fair value of derivatives**	**Contingent liabilities**	**Total credit risk exposure**

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in HUF million	demand deposits		At amortised cost			profit or loss	At fair value			
As of 31 December 2017										
Sovereigns	-	28,985	3,643	583,356	91,522	-	117,057	1,602	30,000	856,165
Institutions	1,031	39,687	21,838	68,544	31,100	-	-	15,440	16,143	193,785
Corporates	-	-	475,952	-	-	-	19,708	4,041	149,077	648,778
Retail	-	-	680,564	-	-	-	-	-	104,713	785,276
Total	**1,031**	**68,672**	**1,181,997**	**651,900**	**122,622**	**-**	**136,765**	**21,083**	**299,933**	**2,484,003**

Credit risk exposure by Basel 3 exposure class and financial instrument December 2016

					Debt securities					
	Cash and cash balances – other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Financial assets - held to maturity	Financial assets - held for trading	Financial assets - at fair value through profit or loss	Financial assets - available for sale	Positive fair value of derivatives	Contingent liabilities	Total credit risk exposure
in HUF million			At amortised cost			At fair value				
As of 31 December 2016										
Sovereigns	-	76,579	540	432,142	116,055	-	113,176	-	60,000	798,492
Institutions	11,048	68,920	32,370	4,526	434	-	24,573	11,964	54	153,889
Corporates	-		388,410	-	1,169	-	-	3,430	101,788	494,797
Retail	-	-	679,116	-		-	-	3	30,117	709,235
Total	**11,048**	**145,499**	**1,100,435**	**436,668**	**117,658**	**-**	**137,749**	**15,397**	**191,958**	**2,156,413**

35.7. Market risk

Definition and overview

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

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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:

Max[sum of positive sensitivities; abs(sum of negative sensitivities)].

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

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

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

Methods and instruments of risk mitigation

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

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

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

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

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

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

Analysis of market risk

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Value at Risk of banking book and trading book
The following tables show the VaR amounts as of 31 December, 2017 and 2016 at 99% confidence level, with a holding period of one day:

2017 in HUF million	Total	Interest	Currency	Price
Erste Hungary	571	574	9	4
Banking book	504	504	-	-
Trading book	68	70	9	4

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

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

The sensitivity of the banking book increased due to the additional funds from the acquisition of the Citi portfolio and their investment mainly into government bonds.. The lower VaR of the trading book was due to the lower trading activity at the end of 2017.
Interest rate risk of banking book
Interest rate risk is the risk of adverse change in the fair value of financial instruments caused by movement in market interest rates. This type of risk arises when mismatches exist between assets and liabilities (including off-balance-sheet items) in respect of their maturities or of the timing of interest rate adjustments.

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

Exchange rate risk

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

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

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

Exchange rate open positions

in HUF million	2016	2017
EUR	324	(6,835)
CHF	(3,482)	(819)
USD	2,170	178
JPY	(13)	7
Other	275	10

Hedging
Banking book market risk management consists of optimizing Erste Hungary's risk position by finding the proper trade-off between the economic value of the Statement of Financial position and forecasted earnings. Decisions are based on the Statement of Financial

Position development, the economic environment, competitive landscape, fair value of risk, effect on net interest income and appropriate liquidity position. The steering body responsible for interest rate risk management is the ALCO. The ALM submits proposals for actions to steer the interest rate risk to the ALCO and implements ALCO's decisions.

In order to achieve the goals of risk management, hedging activities focus on the two main control variables: net interest income and market value of equity risk. In a broader sense, hedging means an economic activity that mitigates risk, but does not necessarily qualify for IFRS hedge accounting. Erste Hungary manages interest rate risk of the banking book by optimizing on-balance and off-balance positions, and applies hedge accounting to minimize profit and loss volatility. The hedging items are mark-to-market, but the corresponding hedged portfolio is not, and this mismatch causes inconsistency. By applying hedge accounting, market value change of hedging derivatives is booked into equity, ensuring a true and fair view. In 2017 Erste Hungary had no hedge accounting related derivatives.

35.8. Liquidity risk

Definition and overview

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

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

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

Employed methods and instruments

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

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

Methods and instruments of risk mitigation

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

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

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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.

2017 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
On-Balance Liquidity GAP	(220,327)	119,026	235,188	(133,887)
Off-Balance Liquidity GAP	(727)	1,491	3,876	2,581

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

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

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

Liquidity buffer

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

2017 in HUF million	< 1 month	1-12 months	1-5 years	> 5 years
Eligible securities	988	168,071	496,517	148,825

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

Financial liabilities

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

Subordinated liabilities

in HUF million	2016	2017
Deposits from banks	213,655	202,560
subordinated	50,599	50,503

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non subordinated	163,056	152,057
Debt securities issued	38,403	44,083
subordinated	3,779	4,043
non subordinated	34,624	40,041

Non-derivative liabilities

2017 in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
Non-derivative liabilities						
Deposits from banks	151,880	162,362	56,955	30,008	45,995	29,405
Deposits from customers	1,540,898	1,544,754	234,431	324,831	606,567	378,925
Debt securities issued	37,584	40,178	63	812	39,303	-
Financial liabilities designated at fair value through profit or loss	44,083	47,415	827	2,994	40,182	3,412
Subordinated liabilities	50,681	63,980	-	2,119	8,647	53,214
Other liabilities	30,228	30,228	9,815	6,804	-	13,609
Total	**1,855,354**	**1,888,917**	**302,090**	**367,568**	**740,694**	**478,564**

2016 in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
Non-derivative liabilities						
Deposits from banks	163,056	168,190	(19,475)	41,966	83,842	61,857
Deposits from customers	1,419,097	1,424,796	1,100,089	214,387	84,036	26,284
Debt securities issued	24,481	26,752	-	536	26,216	-
Financial liabilities designated at fair value through profit or loss	38,403	41,772	2,357	8,572	27,349	3,494
Subordinated liabilities	50,599	60,494	-	2,106	58,388	-
Other liabilities	32,429	32,429	16,942	15,301	53	133
Total	**1,728,065**	**1,754,433**	**1,099,913**	**282,868**	**279,884**	**91,768**

2017 in HUF million	Carrying amount	< 1 month	1-12 months	1-5 years	> 5 years
Contingent liabilities					
Guarantees	31,710	31,710	-	-	-
Committed credit lines -irrevocable	265,686	265,114	572	-	-

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

Counterbalancing capacity

2017 in HUF million	< 1 week	1 week-1 month	1-3 months	3-6 months	6-12 months
Cash, excess reserve	20,292	-	-	-	-

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Liquid assets	772,148	(103)	(42,943)	(68,486)	(28,186)
Other central bank eligible assets	-	-	-	-	-
thereof retained covered bonds	-	-	-	-	-
thereof credit claims	-	-	-	-	-
Counterbalancing capacity	**792,440**	**(103)**	**(42,943)**	**(68,486)**	**(28,186)**

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

Repricing gap

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

2017 in HUF million	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing gap in EUR positions	(36,587)	16,853	2,453	744
Repricing gap in HUF positions	(388,820)	95,380	74,357	606,877
Repricing gap in CHF positions	5,478	1,749	7,262	53
Repricing gap in USD positions	(16,477)	(2,385)	16,784	(9)

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

Maturity of contractual cash flow of derivatives

Derivatives are shown net.

2017 in HUF million	Total contractual cash-flows	< 1 month	1-12 months	1-5 years	> 5 years
HUF	(81,326)	(59,567)	(77,920)	44,891	11,270
EUR	43,454	(42,207)	129,027	(34,807)	(8,559)
CHF	(10,771)	432	(11,074)	-	(129)
USD	44,101	81,109	(30,799)	(6,208)	0
Other	11,763	19,506	(7,743)	-	-

2016 in HUF million	Total contractual cash-flows	< 1 month	1-12 months	1-5 years	> 5 years
HUF	(256,747)	(141,002)	(124,578)	4,716	4,116
EUR	249,190	125,783	126,299	130	(3,022)

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CHF	5,614	6,139	(347)	-	(179)
USD	1,420	2,616	(1,195)	-	-
Other	6,411	7,828	(1,417)	-	-

35.9. Operational risk

Definition and overview

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

Employed methods and instruments

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

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

Methods and instruments of risk mitigation

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

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

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

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

Business Continuity Management

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

Distribution of operational risk events

Detailed below are the types of operational risk event sources as defined by the Basel 2 Capital Accord. The event type categories are as follows

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

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

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

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

Business disruption and system failures:
Losses arising from disruption of business or system failures.

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

The biggest part of the total operational risk loss came from external fraud related events. (The percentage 30% of total on severty base, and 75% of total on frequency base. The observation period is from 1 January 2017 to 31 December 2017.)

36) Fair value of financial and non-financial instruments

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

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

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

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

Cash and balances with central banks
This line includes financial instruments for which fair value is determined on the basis of quoted market prices.

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

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

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

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

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

Level 3 inputs are non-observable. This includes extrapolation of yield curves or volatilities, and the usage of historical volatilities. The fair value of non-financial instruments not measured at fair value is presented under Level 2 and Level 3.
“Assets held for sale”, containing repossessed vehicles are shown in Level 2. The valuation is based on EUROTAX catalogue, which is a public database, generally accepted as a reference of valuation applied by banks and insurance companies. The reference price is refined by corrections related to observable individual characteristic (i.e. scratches, damages) of the vehicles, based on transactions involving vehicles of similar characteristics.
“Investment property” is presented in Level 3. The key element of the profit generating focused valuation is the observable rental price in the given area. The basic prices are refined by the valuators introducing corrective elements valuing the individual features (i.e. terraces, floor). The valuation is made by independent valuator holding EUFIM qualification (Hungarian qualification system elaborated conforming 45013 EU principle) and experiences in the given location.
In Level 3 ‘Derivatives’ and ‘Financial assets available for sale’ are presented. The unobservable element in Level 3 valuation of ‘Derivatives’ is the credit value adjustment (CVA) and debit value adjustment (DVA) represented the counterparty risk related to derivative deals. Erste Hungary is assessing that alternative risk modelling technique would not leave to materially different result.
‘Financial assets available for sale’ contains VISA Inc. shares of which the Level 3 valuation contains a discount related to a potential earn out payment contingent of a minimum holding period, assessing no alternative valuation technique for.

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

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2017	Quoted market prices in active markets	Marked to model based on observable marked data	Marked to model based on non-observable inputs	Total
in HUF million	Level 1	Level 2	Level 3	
Financial assets -held for trading - Derivatives and derivatives hedge accounting	128	20,955	-	21,083
Financial assets –held for trading - Other trading assets	14,898	107,553	171	122,622
Financial assets - available for sale	114,899	8,024	13,842	136,765
Total assets	**129,925**	**136,531**	**14,014**	**280,470**
Financial liabilities – held for trading - Derivatives	183	14,909	-	15,092
Financial liabilities – held for trading - Other trading liabilities	70	-	-	70
Financial liabilities designated at fair value through profit or loss	-	37,584	-	37,584
Total liabilities	**253**	**52,493**	**-**	**52,746**

2016	Quoted market prices in active markets	Marked to model based on observable marked data	Marked to model based on non-observable inputs	Total
in HUF million	Level 1	Level 2	Level 3	
Financial assets -held for trading - Derivatives and derivatives hedge accounting	114	13,662	1,620	15,397
Financial assets –held for trading - Other trading assets	85,493	32,165	0	117,658
Financial assets - available for sale	105,465	29,464	2,041	136,970
Total assets	**191,072**	**75,291**	**3,661**	**270,025**
Financial liabilities – held for trading - Derivatives	58	11,280	-	11,337
Financial liabilities – held for trading - Other trading liabilities	1,060	-	-	1,060
Financial liabilities designated at fair value through profit or loss	-	12,249	12,232	24,481
Total liabilities	**1,118**	**23,529**	**12,232**	**36,879**

The table below shows the movement within Level 3 category:

in HUF million	01.01.2017	Purchase	Sale/ Settlement	Gains/ Losses in other comprehensive income	Gains/ Losses in income statement	Transfer into Level3	Transfer out of Level3	Exc-hange rate effect	31.12.2017
Financial assets - held for trading	1,620	171	-	-	(68)	-	(1,531)	(21)	171
Derivatives & Derivatives - hedge accounting	1,620	-	-	-	(68)	-	(1,531)	(21)	0
Financial assets - available for sale	2,041	-	(4,847)	(19)	3,769	12,981	-	(83)	13,842
Financial liabilities held for trading	-	-	-	-	(5)	-	5	0	0
Financial liabilities designated at fair value through profit and loss	12,232	-	-	-	-	-	(12,232)	-	-

in HUF million	01.01.2016	Purchase	Sale/ Settlement	Gains/ Losses in other comprehensive income	Gains/ Losses in income statement	Transfer into Level3	Transfer out of Level3	Exc-hange rate effect	31.12.2016
Financial assets - held for trading	1,829	-	-	-	(247)	479	(401)	(39)	1,620
Derivatives & Derivatives - hedge acco-unting	1,829	-	-	-	(247)	479	(401)	(39)	1,620
Financial assets - available for sale	4,696	1,309	(4,060)	289	(304)	1,028	(980)	64	2,041
Financial liabilities held for trading	-	-	-	-	(18)	(101)	119	(0)	(0)
Financial liabilities designated at fair value through profit and loss	-	12 000	-	-	232	-	-	-	12 232

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:

2017 in HUF million	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable mar-ket data Level 2	Marked to model based on non-observable inputs Level 3
ASSETS	**1,865,592**	**1,917,702**	**646,894**	**46,677**	**1,224,131**
Cash and balances with central bank	21,324	21,324	21,324	-	-
Loans and receivables to credit institutions	68,672	68,961	-	-	68,961
Loans and receivables to customers	1,123,696	1,150,654	-	-	1,150,654
Financial assets - held to maturity	651,900	676,764	625,571	46,677	4,516
LIABILITIES	**1,838,208**	**1 837,056**	**-**	**41,858**	**1,795,198**
Deposits from banks	202,560	198,730	-	-	198,730

Deposits from customers	1,540,899	1,541,759	-	-	1,541,759
Debt securities issued	44,083	45,900	-	40,595	5,305
Subordinated liabilities	50,666	50,666	-	1,263	49,403

2016 in HUF million	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable market data Level 2	Marked to model based on non-observable inputs Level 3
ASSETS	**1,709,449**	**1,714,422**	**547,896**	**4,568**	**1,161,958**
Cash and balances with central bank	106,050	106,050	106,050	-	-
Loans and receivables to credit institutions	145,499	145,624	-	-	145,624
Loans and receivables to customers	1,021,232	1,016,334	-	-	1,016,334
Financial assets - held to maturity	436,668	446,414	441,845	4,568	-
LIABILITIES	**1,721,960**	**1,709,471**	**-**	**19,909**	**1,689,562**
Deposits from banks	213,655	205,107	-	-	205,107
Deposits from customers	1,419,097	1,414,033	-	-	1,414,032
Debt securities issued	38,403	38,891	-	15,024	23,868
Subordinated liabilities	50,805	51,440	-	4,885	46,555

2017 in HUF million	Note	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable market data Level 2	Marked to model based on non-observable inputs Level 3
Assets whose Fair Value is disclosed in the notes		**10,347**	**10,347**	**0**	**0**	**10,347**
Investment properties		10,347	10,347	0	0	10,347
Assets whose Fair Value is presented in the Statement of Financial Position		**8,114**	**8,114**	**0**	**1**	**8,113**
Assets held for sale (IFRS 5)	21	1	1	0	1	0
Repossessed assets (IAS 2)	22	8,113	8,113	0	0	8,113

2016 in HUF million	Notes	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable market data Level 2	Marked to model based on non-observable inputs Level 3
Assets whose Fair Value is disclosed in the notes		**10,620**	**12,580**	**0**	**0**	**12,580**
Investment properties		10,620	12,580	0	0	12,580
Assets whose Fair Value is presented in the Statement of Financial Position		**11,338**	**11,338**	**0**	**188**	**11,150**
Assets held for sale (IFRS 5)	21	188	188	0	188	0
Repossessed assets (IAS 2)	22	11,150	11,150	0	0	11,150

37) Financial instruments per category according to IAS 39

2017 in HUF million	Loans and receivables	Held to maturity	Trading	Available for sale	Financial liabilities designated at fair value through profit or loss	Financial assets and financial liabilities at amortised cost	Total
ASSETS							
Cash and cash balances with central bank	21,324	-	-	-	-	-	21,324
Financial asstes held for trading	-	-	143,705	-	-	-	143,705
Derivatives	-	-	21,083	-	-	-	21,083
Other trading assets	-	-	122,622	-	-	-	122,622
Financial assets – available for sale	-	-	-	136,765	-	-	136,765
Financial assets – held to maturity	-	651,900	-	-	-	-	651,900
Loans and receivables to credit institutions	68,672	-	-	-	-	-	68,672
Loans and receivables to customers	1,123,696	-	-	-	-	-	1,123,696
Other assets	-	-	-	-	-	27,791	27,791
Total	**1,213,692**	**651,900**	**143,705**	**136,765**	**-**	**27,791**	**2,173,853**
LIABILITIES							
Financial liabilities held for trading	-	-	15,162	-	-	-	15,162
Derivatives	-	-	15,092	-	-	-	15,092
Other trading liabilities	-	-	70	-	-	-	70
Financial liabilities designated at fair value through profit or loss	-	-	-	-	37,584	-	37,584
Debt securities issued	-	-	-	-	37,584	-	37,584
Financial liab. measured at amortised costs	-	-	-	-	-	1,787,542	1,787,542
Deposits from banks	-	-	-	-	-	202,560	202,560
Deposits from customers	-	-	-	-	-	1,540,898	1,540,899
Debt securities issued	-	-	-	-	-	44,083	44,083
Other financial liabilities	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	30,228	30,228
Total	**-**	**-**	**15,162**	**-**	**37,584**	**1,817,770**	**1,870,516**

2016 in HUF million	Loans and receivables	Held to maturity	Trading	Available for sale	Financial liabilities designated at fair value through profit or loss	Financial assets and financial liabilities at amortised cost	Total
ASSETS							
Cash and cash balances with central bank	106,050	-	-	-	-	-	106,050
Financial asstes held for trading	-	-	133,055	-	-	-	133,055
Derivatives	-	-	15,397	-	-	-	15,397
Other trading assets	-	-	117,658	-	-	-	117,658
Financial assets – available for sale	-	-	-	137,749	-	-	137,749
Financial assets – held to maturity	-	436,668	-	-	-	-	436,668
Loans and receivables to credit institutions	145,499	-	-	-	-	-	145,499
Loans and receivables to customers	1,021,232	-	-	-	-	-	1,021,232
Other assets	-	-	-	-	-	27,486	27,486
Total	**1,272,781**	**436,668**	**133,055**	**137,749**	**-**	**27,486**	**2,007,739**
LIABILITIES							
Financial liabilities held for trading	-	-	12,398	-	-	-	12,398
Derivatives	-	-	11,337	-	-	-	11,338
Other trading liabilities	-	-	1,060	-	-	-	1,060
Financial liabilities designated at fair value through profit or loss	-	-	-	-	24,481	-	24,481
Debt securities issued	-	-	-	-	24,481	-	24,481
Financial liab. measured at amortised costs	-	-	-	-	-	1,671,155	1,671,155
Deposits from banks	-	-	-	-	-	213,655	213,655
Deposits from customers	-	-	-	-	-	1,419,097	1,419,097
Debt securities issued	-	-	-	-	-	38,403	38,403

Other financial liabilities	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	32,429	32,429
Total	**-**	**-**	**12,398**	**-**	**24,481**	**1,703,584**	**1,740,463**

38) Audit fees and consultancy fees

The following table contains audit and tax fees charged by the auditors, PwC in the fiscal years 2017 and by Ernst & Young in 2016:

in HUF million	2016	2017
	408	204

The total balance charged by Ernst & Young for 2016 consists of 222 million forint for audit fee, 75 milion forint for tax and evaluation consulting services and 111 million forint for other services (gross amounts, value-added tax included).

The total balance charged by PwC for 2017 consists of 183 million forint for audit fees and 21 million forint for other services involving the issuance of a report (gross amounts, value-added tax included).

39) Contingent liabilities

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

in HUF million	2016	2017
Irrevocable contingent liabilities	**191,958**	**299,932**
Guarantees	23,855	31,710
Committed credit lines -irrevocable	165,989	265,686
Import accreditives	2,114	2,536
Revocable contingent liabilities	**104,358**	**98,188**
Committed credit lines - revocable	104,358	98,188
Other contingent liabilities	**1,290**	**3,800**
Legal cases	192	2,409
Other	1,098	1,391
Total	**297,606**	**401,920**

Related Provision see note 25, page 46.

Legal proceedings

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

To a great extent these proceedings relate to disputes regarding the validity of clauses in contracts with consumers. Foreign currency loan related invalidity lawsuits by consumers against banks, including the Bank, were suspended by the regulations of the 2014 consumer loan laws until the completion of the settlement and refund process towards the customers concerned. While some plaintiffs did not pursue their claims further, the Bank remained a defendant in several of these litigation procedures. Regardless of the settlement, consumers continue to initiate further court cases, creating a level of uncertainty on assessing the potential financial impact in case of adverse adjudications.
The level of uncertainty related to the outcome of these litigations has also been increased by the Hungarian local courts initiating the preliminary ruling of European Court of Justice (“ECJ”) in several proceedings (4 cases against EBH and 4 cases against other Hungarian banks). The questions referred to the ECJ mainly examine the compliance of FX loan agreements and the regulation of the 2014 consumer loan laws with the provisions of 93/13/EEC Council Directive on consumer protection. As a result of these pending procedures, numerous other pending lawsuits have been suspended until the ECJ adopts its preliminary rulings. Furthermore,

in case the ECJ's rulings would be favorable for the plaintiffs, this might lead to an increase of the number of pending lawsuits against EBH.

40) Analysis of remaining maturities

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

in HUF million	2016		2017	
	< 1 year	> 1 year	< 1 year	> 1 year
Cash and cash balances with central bank	106,050	-	21,324	-
Financial assets - held for trading	91,965	41,090	93,138	50,567
Financial assets - available-for-sale	5,975	131,774	13,767	122,998
Financial assets - held to maturity	58,330	378,338	117,235	534,665
Loans and receivables to credit institutions	145,499	0	68,671	-
Loans and receivables to customers	253,592	767,640	249,730	873,967
Property and equipment	-	8,991	-	18,947
Investment properties	-	10,620	-	-
Intangible assets	-	18,310	1	25,564
Current tax assets	1,000	-	704	-
Deferred tax assets	-	33	-	-
Non-current assets and disposal groups classified as held for sale	187	-	-	1
Other assets	21,898	5,588	25,428	2,363
TOTAL ASSETS	**684,497**	**1,362,384**	**589,998**	**1,629,071**
Deposits from banks	71,884	91,172	86,963	64,917
Deposits from customers	592,960	826,136	557,656	983,242
Debt securities issued	9,507	28,896	3,354	40,730
Financial liabilities held for trading	8,222	4,176	10,916	4,247
Financial liabilities designated at fair value through profit or loss	-	24,481	-	37,584
Provisions	4,663	20,493	4,672	4,019
Current tax liabilities	9	-	-	-
Deferred tax liabilities	-	238	-	584
Other liabilities	32,244	186	16,619	13,609
Subordinated liabilities	-	50,599	-	50,681
Total equity	-	281,015	-	339,278
attributable to				
non-controlling interests	-	-	-	-
owners of the parent	-	281,015	-	339,278
TOTAL LIABILITIES	**719,489**	**1,327,392**	**680,180**	**1,538,891**

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

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

Erste Hungary manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, Erste Hungary may adjust the amount of dividend payment to shareholders or return capital to shareholders. No changes have been made to the objectives, policies and processes from the previous years.
The calculation is made in accordance with Hungarian regulatory requirements, conform to EU regulation, and based on consolidated IFRS.

During 2017 and 2016 the Bank and Erste Hungary had complied in full with all its externally imposed capital requirements.

in HUF million	2016	2017

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Tier 1 capital before deductions	237,633	339,278
Deductions from the Tier 1 capital (-)	20,478	70,889[1)]
Tier 1 capital after deductions	**217,155**	**268,389**
Tier 2 capital	55,813	52,676
Deductions from the Tier 2 capital (-)	-	(3,061)
Total qualifying own funds	**272,968**	**324,126**
Risk weighted assets (base for credit risk)	1,118,618	1,227,477
Capital requirement for credit risk	**89,489**	**98,198**
thereof IRB approach	79,050	90,500
thereof standardized approach	10,439	7,698
Capital requirement for market risk	**2,803**	**1,376**
thereof calculated with simple approach	2,803	1,376
thereof from debt instruments	1,067	1,321
thereof from capital instruments	4	43
thereof open fx-positions	1,732	12
Other capital requirements for credit valuation adjustment	**551**	**668**
Pillar 2 requirement (only the Bank)	**-**	**-**
Capital requirement for operational risk	**30,605**	**34,536**
Total base for capital requirement	**1,543,096**	**1,684,729**
Total capital requirement	**123,448**	**134,778**
Tier 1 ratio	**14.07%**	**15.93%**
Solvency ratio	**17.69%**	**19.24%**
Solvency ratio after pillar 2 deduction	**17.69%**	**19.24%**

1) The deductions contain 40 billion forint dividend proposed to the General Meeting but not yet approved at the signature date of the financial statement.

42) Events after the balance sheet date

At Erste Bank Hungary Zrt's Annual general meeting, to be held 26 April, proposal of dividend payment amounting to 40 billion forint is presented, that will be paid during 2018.

43) Details of the companies wholly or partly-owned by Erste Bank Hungary Zrt. at 31 December 2017 and 2016 respectively

Company name	Interest of Erste Bank Hungary in % - directly or indirectly at 31.12.2016	Interest of Erste Bank Hungary in % - directly or indirectly at 31.12.2017
Subsidiaries:		
Erste Befektetési Zrt.	100%	100%
Erste Lakáslízing Zrt.	100%	100%
Erste Ingatlan Kft.	100%	100%
Sió Ingatlan Invest Kft.	100%	100%
Erste Lakástakarék Zrt.	100%	100%
Erste IN-FORG Kft.	100%	merged into Collat-Reál Kft
Collat-reál Kft.	100%	100%
Erste Jelzálogbank Zrt.	100%	100%
Other investments:		
Erste Vienna Insurance Group Zrt.	5%	5%
Budapest Stock Exchange Ltd.	2.3%	2.3%
Garantiqa Hitelgarancia Zrt.	2.1%	2.1%
Kisvállalkozás-fejlesztési Pénzügyi Zrt.	1.1%	1.1%
MasterCard Incorporated (USD)	0.01%	sold
VISA Incorporated (USD)	0.002%	0.0005%

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Business Report

for

the Consolidated Financial Statements of Erste Bank Hungary Zrt.

in accordance with International Financial Reporting Standards as adopted by the European Union

Concerning Year 2017

Budapest, 13 April 2018

Company registration number:

Budapest Metropolitan Court

01-10-041054

The Consolidated Financial Statements and Business Report for 2017 of ERSTE Bank Hungary Zrt. and its subsidiaries ("Erste Hungary") contains primarily a summary of its banking activities, supplemented with the information that affected Erste Hungary's operation for the purposes of the evaluation of its business operation

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BUSINESS ENVIRONMENT, OBJECTIVES AND STRATEGY OF ERSTE HUNGARY

Based on data adjusted for seasonal and calendar effects, the performance of the Hungarian economy grew by 4.0% in the first three quarters of 2017, compared to the 2.1% increase in the previous year. Third quarter growth resulted in an increase of 3.8% in performance in comparison to the same period of the previous year. This is primarily due to the contribution of construction and manufacturing industries. Until the third quarter of 2017, the performance of construction increased by 27.6%, whilst agricultural performance decreased by 10.5% although from a high base. Despite agriculture under performance, the balance of the economy (predominantly manufacturing) grew until the third quarter of 2017. Generally, 2017 as a whole, and based on preliminary data, witnessed an overall growth in the economy of 4.2%.

With regards to internal consumption, the positive trend continued in 2017. In the first three quarters of 2017, retail consumption increased by 4.3%, and the overall volume of investments in the national economy grew more than 20% quarter on quarter in comparison with the same period of the previous year. This is due in part to the increasing utilization of EU funds and the dynamic increase in construction

By the close of the third quarter (2017) the total foreign trade export volume of the country grew by 6.5%, while the total foreign trade import volume grew by 9.5% as compared with the same period of year 2016. Both the export of goods and services slowed down in the third quarter compared to the first half of the year. Unemployment rate is decreasing and has been reported below 10% since the second half of 2013. By the close of 2017 unemployment fell to 3.8% due to the increasing employment in the private sector. However, the low unemployment rate is influenced by the government's public work programs.

In December 2016, consumer prices were 2.1% higher on average than the previous earlier. The highest price increases during this period were for food, alcoholic beverages and tobacco. During 2017 as a whole, consumer prices rose by 2.4% on average compared to the previous year. The highest price rises were recorded for other goods including motor fuels, alcoholic beverages and tobacco. Only the prices of consumer durables decreased.

The interest rate cutting cycle of the National Bank of Hungary ceased May 2016. From that point onwards, the Central Bank retained the benchmark rate at a historically low level of 0.9%, while the 12-month interbank rate decreased further to 0.1%.

Tight labour market conditions, coupled with increases in real wages, suggest that household consumption is projected to be the main driver of economic growth in 2018. In addition, investments may again contribute positively to economic growth due to the expected acceleration in the utilization of EU funds. Moreover, the ongoing loose monetary conditions should help both consumption and investments. On the other hand, the risks related to Brexit and the presidency of Trump in the US may pose risks to trade developments.

In 2017, retail loan portfolio, as a balance of disbursements and repayments, have started to grow compared to the end of the previous year which is a result of a significant increase in new disbursements. In particular, housing loan volumes increased mainly supported by home purchase state subsidy for families (CSOK).However, unsecured consumer loans increased as well. During 2017, both housing loan and consumer loan conditions softened. The Funding for Growth Scheme ended in March 2017, whilst the total corporate loan volume further increased significantly. Loan portfolio growth was driven by volume growth of HUF loans. SME segment lending growth was realized with increasing demand and an easing of loan supply constraints. On the liability side, despite the result of the squeezing out the effect of the low interest rate environment and alternative investment opportunities, the retail deposit portfolio of the sector slightly increased, whilst due to the savings of the corporate and other segments, the total deposit portfolio increased significantly.

The Memorandum of Understanding, signed by the Hungarian Government and the European Bank for Reconstruction and Development (EBRD) in February 2015 and in relations to the banking tax reduction from 2016, meant a positive change to the banking sector. However, financial transaction duty and free cash withdrawal remain in effect. Additionally, bankruptcy of the brokerage companies in the first half of 2015resulted in increased burdens to the financial sector as compensation of customers is borne by the financial institutions.

Looking ahead to the coming years, changes in legislation and governmental measures will have an impact on profits: the increase in the fees to be paid to the National Deposit Insurance Fund (OBA) and the Investor Protection Fund (BEVA) have a negative effect on the banking sector's income, whilst the reduction of the bank levy and the allowance that can be received in the bank levy have a positive impact.

Based on the changing market environment, Erste Hungary focuses on growth potentials and plans to remain a significant player in both the retail and corporate segments in Hungary. In February 2017, the Bank completed one of the most significant Hungarian bank acquisitions in the last years by acquiring the Hungarian consumer banking business of Citibank Europe plc. As part of the acquisition process, making headway in asset management, Erste Hungary launched the new Erste World segment in March 2016 and expanded its mass-affluent and private banking services. One of the companies indirectly owned by Erste Bank Hungary Zrt., ERSTE IN-FORG Kft. merged into Collat-real Kft. which is also indirectly owned by the Bank dated July 3, 2017.

The strategic goal of Erste Hungary is to continue its operation as a major player of the Hungarian banking market with the support of a well-balanced corporate business, reinforced risk management, efficient operations and a continuously improving service quality focusing on retail customers who regard EBH as the number one financial institution. Erste Hungary provides a wide range of financial products and services to its customers throughout their whole financial lifecycle: deposits, investments products, loans, advisory services and leasing products. Retaining its position as a leading retail lending institution, together with the acquisition of Citibank's retail business line, the Bank intends to emerge as a market leader in the private banking and credit card business lines, as well as in terms of electronic channels and innovative solutions, and furthermore lays great emphasis on retaining its solid share in the market of savings. Apart from its core banking activities, Erste Hungary plays an important role in the market of products having a significant growth potential such as investment and building society services.

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

Change in Erste Hungary's form of operation

Erste Hungary's form of operation and ownership structure did not change during the business year of 2017. The change in the corporate form of Erste Bank Hungary Zrt. to private limited company (Zrt.) was registered by the Court of Registration as of 3 January 2011. The full name of the Bank is Erste Bank Hungary Zártkörűen Működő Részvénytársaság.

The ownership structure of Erste Hungary is the following:

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

Other changes

ERSTE IN-FORG Kft., which, is indirectly owned by Erste Bank Zrt, merged into Collat-real Kft. which is also indirectly owned by the Bank dated July 3, 2017.

PRODUCT RANGE, COOPERATION AGREEMENTS, STRATEGIC ALLIANCES

The real estate boom started in 2016 continued throughout 2017 resulting in a 38% growth of mortgage loans outperforming analyst expectations. The boom was supported by real estate investments; improvement of residents' financial situation; reduction of unemployment rate; a favorable supporting system; and low interest rate environment. The assumption of Erste Hungary is that the aforementioned factors will create a supporting environment for new disbursement of mortgage loans in the future. Erste Bank Hungary Zrt expects slower but further market increases in 2018. Erste Hungary's share in retail lending market showed an increasing trend in 2017, in regards housing mortgage loans and home equity loans.

The National Bank of Hungary has created a "consumer-friendly home loan" certification named "Minősített Fogyasztóbarát Lakáshitel" to strengthen the competition in the banking market; to increase transparency of mortgage loans; and to increase comparability of loans. Erste Hungary was one of the first retail banks to launch this product, by introducing the first certified three-year interest period mortgage loan The measures of National Bank of Hungary increased the ratio of loans with long interest periods from 50% to 60% in the market in the second half of 2017. This ratio in the case of Erste Hungary

– receiving credit demand since the introduction of certified loans – is higher than 80%. The certified loans can be used for house building and refinancing existing housing loans. Moreover, customers can utilize Erste loans to purchase apartments.

Erste Hungary introduced a credit card instalment service - “Hitelkártya Részletfizetési Szolgáltatás” - at the close of 2016 Due to the “Tele-Kölcsön” service, the customers with a credit card can acquire a loan via phone based on monthly payments. Via “Könnyített Törlesztés” service, instalment payment can be chosen after purchasing with credit card. This service can be provided via either telephone or NetBank. These new services largely contributed to the development of credit card business.

To increase its consumer credit portfolio, Erste Hungary engaged in continuous branch and contact center campaigns. Furthermore, the Bank adopted a new sales channel using the services of third parties in 2017.

Before the integration of Citibank’s retail branch, Erste Hungary’s previous credit card product was removed from the market in January 2017.Two new types of credit cards were introduced. The MAX credit card addresses “mass” customers with the opportunity of refund in certain categories customized by the customer. The Erste Platinum credit card addresses specifically the clients of Private Banking and Erste World segments. The option of refund is available in three fixed categories, whilst the card owners can access exclusive services.

Erste Hungary introduced “Erste Adókedvezményes“ Account Package in February 2017 in accordance with Act CXCIV of 2011 on the economic stability of Hungary.

In July 2017, the CAD currency account was introduced which is available for both existing and new customers.

Bank accounts provided to employees which were based on a contract between employers and Erste Hungary were renewed on 1 August 2017: Erste Hungary introduced four new account types which are intended to address customers transferring their salaries to Erste Hungary and use their accounts and debit cards on a daily basis. The new accounts are available through a framework contract with the clients have an option to open and keep limitless number of HUF and foreign currency accounts for one monthly customer relations fee. Furthermore, the account attached to debit cards can be modified at any time (it can be a HUF or foreign currency account), and an SMS service is available for a fixed fee covering all accounts.

In regards of the insurances, several products were launched in 2017. Cooperating with UNION Vienna Insurance Group Biztosító Zrt., Erste Hungary introduced a travel insurance product. Before the introduction of this new product, a similar service was available only for credit card services Erste Hungary renewed its repayment protection insurance product aligning with customer requirements. Lastly, Erste launched the “Erste Euro Smart” life insurance allowing customers to save money in a full investment range paying once and not on a regular basis.

Four new accounts were introduced for micro-enterprises in 2017. The “Erste Smart” Account Package’s monthly fee is adjusted to the enterprise’s current account turnover. It includes the HUF electronic transfer transactions and automatically adjusts to the customer’s habits (outgoing account turnover). To support the introduction of this product, the first six monthly fee of the accounts opened from October to December was released.

The "Erste 100 Forintos" Account Package was shaped for the needs of the smaller and recently founded companies, which operate with lower revenues and for those micro-enterprises which have seasonal activity based revenues. The monthly fee remained low in case of unaccounted or very low turnover. The introduction of the product was actively supported with a marketing campaign.

Erste Hungary serves customer needs for foreign currency accounts with the "Erste Deviza Plusz" Account Package as well as „Erste Deviza Light" Account Package. The former account targets micro-enterprises with higher revenues and a significant number of foreign currency transactions whilst latter account targets micro-enterprises with smaller revenues and turnover.

The micro-enterprise lending services received new impetus in 2017. The Széchenyi Card overdraft facility was renewed and Erste Hungary adjusted its ruleset to the market demand in accordance with the changes of the framework. Consequently, strong product-sales focus was implemented and, as a result, the amount of new disbursements was three times higher in Q4 compared with the same period of the previous year.

In 2017, the agricultural sector was in focus with Erste Hungary providing specifically designed credit products via branch and telesales marketing campaigns.

In conjunction with "Mikrovállalati Egyszerű Folyószámlahitel", the Bank introduced the „Kisvállalkozói Lépéselőny Folyószámlahitel", providing small amount loans to current customers with an existing account. It is an overdraft facility based on account turnover and is easily accessible. The duration of the credit rating process is short due to the currently existing connection with the enterprises.

Erste Hungary provides an all-inclusive financing service to companies and municipalities managed under the corporate business line. Being part of this activity, the Bank provides HUF and foreign currency loans from its own resources or in the form of refinancing issues credit cards and bank guarantees; opens letters of credit; and provides leasing financing and factoring services to its partners. The Bank takes part in project finance as well as in syndicated loans, too.

Fixed Interest Rate Loans were remarkable among financing products in year 2017. Under the NBH's Funding for Growth Scheme, and the foreign currency loans refinanced by EXIM and self-funded – Erste Growth program – products offered ensured interest rate risk free, mid-term financing to customers.

Besides the financing products provided with the guarantees of Garantiqua and the Rural Credit Guarantee Foundation, since 2017 Erste Hungary has been providing loans covered with COSME guarantee which enabled the Bank to expand the range of our financed customers via risk sharing with institutional guarantors.

In the corporate lending business, the customer focus approach to lending and increasing the level of system support was a key factor in the increasingly high levels of customer service. Considering aspects of risk management, the lending process was continuously developed and also cycle times have been accelerated.

In February 2017, after Citibank acquisition, Erste Hungary obtained a solid second place in Wealth Management segment. Further during 2017, the Bank stabilized its position by achieving organic growth. The aforementioned acquisition enlarged the Bank's product spectrum utilizing the best practices from both organizations. The product penetration was maximized by focusing on investment offers, core banking services, financing and other convenient services. The number of branches increased with acquiring the former Citibank locations. Furthermore, in the premium segment the Bank launched a new framework contract account in March 2017.

MAIN RESOURCES AND RISKS, AND THE RELATED CHANGES AND UNCERTAINTIES

Asset-liability management (interest rate risk management)

Erste Hungary utilizes a simulation procedure which is one of the more advanced methodology solutions to measure the interest rate risk of its banking book as that method takes into account both traditionally applied approaches, i.e., the net interest-income simulation (income perspective) and the cash flow assessment, i.e., the economic value simulation (economic perspective). The highest-level strategic decisions on asset-liability management and, more specifically, interest rate risk management, are made by the Asset-Liability Committee (ALCO). In accordance with its responsibilities, the Committee regularly reviews the interest rate risk situation of Erste Hungary and the development of its positions. In addition to monitoring the position, the Committee also has the right to evaluate and rate Erste Hungary's interest rate risk position. Its competence includes the approval and modification of applicable internal regulations with special regard to the modification of effective limits, assumptions, procedures and methods. Other organizational units involved in interest rate risk management: (1) Asset-Liability Management (ALM), which prepares decisions and supports the activities of ALCO, (2) Capital Markets, which performs the operational implementation of the strategic decisions of ALCO and the market transactions of ALM. Erste Hungary's management receives regular reports on banking book interest rate risk variation. Those reports enable the management:

- to evaluate the level and trend of Erste Hungary's total interest rate risk exposure;
- to validate compliance with the defined risk tolerance levels;
- to identify potentially excessive risks undertaken in excess of the level set forth by the relevant policy;
- to determine if Erste Hungary has enough capital to undertake the respective interest rate risk;
- to undertake decisions related to interest rate risks.

Liquidity risk management

The Bank uses a *Survival Period Analysis* based on stress scenarios to measure its shorter-term liquidity risks. The analysis shows for how long Erste Hungary would be able to fulfil its payment obligations in various liquidity stress scenarios under specific conditions. ALM is responsible for coordinating the maturity structure of on-balance and off-balance items by ensuring that the aggregated net cash flows remain positive for the period of time specified as the limit. In addition to the survival period analysis based on stress scenarios; compliance with the liquidity ratios introduced by Hungarian regulators (Foreign funding adequacy ratio, Foreign currency equilibrium ratio) as well as compliance with the expected levels of the liquidity ratios (LCR, NSFR) introduced by the Basel Committee on Banking Supervision are also taken into account when managing liquidity risks. Counterparty and Market Risk Management Department regularly monitors and reports to ALCO the current figures of liquidity ratios.

During the year, the gross client loan portfolio increased significantly. The development of the net loan portfolio was further helped by the decreasing risk provision. Both retail and corporate loan portfolios increased. The volume of client deposits grew significantly in 2017, largely due to increasing demand deposit portfolios of retail clients. The non-financial deposit portfolio also grew during the year whilst the level of deposits from financial clients declined significantly. The flow of liquidity from term deposits to sight deposits was observable in all client segments.

In 2017, Erste Hungary extended the maturity of 163 million EUR subordinated deposits till 2024.

Interest rate risk management

Erste Hungary applies two analytical methods to quantify interest rate risk: a) the net interest income method, and b) the simulation of the market value of total equity.

Both types of risk indicators suggest a medium interest rate risk exposure. Both the external and the internal limits were met during the year. The increase in the market sensitivity of total equity is a consequence of the risk of the modelled products, which has increased due to the low yield environment.

Sensitivity of the market value of the total equity:

It is expressed as the absolute sum total of the variation of the economic capital value by currency occurring as a result of a parallel, 200 basis point assumed change in interest rates, in any direction, compared to the capital amount calculated with an unchanged interest rate scenario.

Sensitivity of the net interest income, simulated for 12 months:

It is expressed as the absolute sum total of the variation of the 1-year net interest income by currency, occurring as a result of parallel, 200 basis point assumed change in interest rates, compared to the net interest income calculated with an unchanged interest rate scenario.

Table No. 1	**2016.12.31**	**2017.12.31**
Sensitivity of the total equity	6.76%	4.19%
Sensitivity of the net interest income, simulated for 12 months	7.16%*	9.33%

*Sensitivity of the net interest income, simulated for 12 months in 2016, is calculated by +100basis point change in interest rate

The repricing table classifies the volumes of assets, liabilities and off-balance sheet items into time bands, in the main currencies, according to the next repricing date. The repricing gap is calculated after the classification, as the difference of the assets and liabilities.

At the end of 2017, the portfolios denominated in HUF had a positive repricing gap. The positive gap of the longer terms (>= 5 years) resulted primarily from the longer-term government securities portfolio with a fixed interest rate and the retail loan portfolio.

The interest-bearing items, denominated in USD and EUR, are dominated by deals priced within one year, i.e. those statement of financial position components carry generally low repricing risks. In the case of interest-bearing items denominated in CHF, we have surplus assets due to the CHF corporate loan portfolio. The table below does not include the demand deposit portfolio, whose maturities are modelled

Table No.2 *Data in millions of HUF*

2017 in HUF million	0 - 3 months	3 - 6 months	6 - 12 months	over 1 year
Repricing gap in EUR positions	(36,587)	16,853	2,453	744
Repricing gap in HUF positions	(388,820)	95,380	74,357	606,877
Repricing gap in CHF positions	5,478	1,749	7,262	53
Repricing gap in USD positions	(16,477)	(2,385)	16,784	(9)

The Asset-Liability Committee (ALCO) is responsible for managing interest rate and liquidity risks at the highest decision making level.

FINANCIAL DATA

Erste Hungary's Net profit set a new record in 2017 –in comparison to 2016 year-end result. Revenues grew by 16% on annual basis. The key factors were the migration of Citibank; the considerably lower risk provisioning mainly as a result of one-off releases; and the substantially lower banking tax.

Erste Hungary's Total assets reached 2,219 billion forint by the end of 2017, which corresponds to a 8.4% year-on-year growth. Erste Hungary reported a 54.7 billion forint After tax profit for 2017.

The structure of Erste Hungary's asset portfolio showed a significant change at the end of 2017 in comparison to the preceding year. The portfolio of held to maturity investments grew approximately by 215 billion forint. However, their share within the balance sheet total increased by only 8% on previous year's level.

In parallel, Loans to credit institutions declined together with their share within Total assets (3% vs 7% in 2016) and the Cash and cash equivalents at central bank also decreased (1% vs 5% in 2016). Placements with the National Bank of Hungary (NBH) decreased by 104.3 billion forint mainly as a result of diminishing interest rate environment and a limited amount of excess liquidity.

The net volume of Loans to customers increased mainly as a result of growing new disbursements and migrated Citi loan portfolio. The total increase was 102 billion forint. Though the contribution by the different Business Lines varied, i.e. Retail portfolio increased by 5% due to the migration of Retail Business of Citi Bank. Furthermore Corporate volumes grew substantially above the market by 30%.

At the end of 2017, the portfolio structure within liability side was roughly the same as previous year. Deposits from credit institutions decreased by 3 billion forint since the preceding year, thereof short-term deposits from the parent company went significant down, while long-term interbank deposits rose. Overall, the share of Amounts owed to credit institutions within the balance sheet total remained on the previous year's level at 10%.

Customer deposits increased significantly by 122 billion forint in 2017 although their share within the total balance sheet remained at the level of 2016 (69%). A boost in customer deposit base was triggered by Citi portfolio migration. The dynamic increase was coupled with structural changes; i.e. the significant decrease of term deposits by 121 billion forint could be compensated by the 217 billion forint increase of demand deposits in the Bank only book that was further compensated with the collected deposit increase of Building society company to get the overall increase of 122 billion forint (as compared to the Bank only 90 billion forint increase). At 2017 year-end, Erste Hungary had a 7,92% market share regarding retail deposits, which corresponded to a 189 bps rise compared to preceding year. While market share of sight deposits increased by

293 bps during 2017 over 2016, term deposits decreased by 67 bps over the same period, attributable to subdued demand for this saving product, caused by diminishing interest rate environment.

There were no major changes in the structure of deferred income and other liabilities. The share of own equity within Total liabilities increased to 15%.

Erste Hungary's Operating income increased whilst Operating expenses grew in a lesser extent compared to the previous year, resulting in a 54.7 billion forint Net result at the end of 2017.

Regarding the elements of Operating income, Net interest income was up by 15.3% (8.7 billion forint) compared to previous year.Within the net amount, interest income increased by 2.6 billion forint, whilst interest expenses were lower by 6 billion forint (-39%).

The income side was boosted by the interest income earned on securities.In parallel to this, the securities portfolio grew substantially due to additional liquidity from migrated Citi portfolio. The higher interest income realized on Retail customer loan volume increased due to the growth of personal loan and credit card portfolio.

Interest income on interbank placements grew moderately.

The 6 billion forint improvement on interest expenses was caused by the diminishing interest paid on Retail, non-financial and other private term deposits primarily due to the low level of the interest rate environment. Further to this, the restructuring of savings towards sight deposits as well as the interest paid on interbank deposits also contributed to the sinking interest expenses. Interest paid on interbank loans also decreased.

The Net fee and commission income of the Bank improved (partly due to acquistion of Citibank), and was by 4.5 billion forint higher than the amount of the previous year. The growth induced by the aforementioned increase in revenues, whilst expenses were slightly higher. Both payment transfer- and distribution fees rose.

Net trading income increased by 4 billion forint as compared to the previous year mainly due to the realized gain on securities.

Operating expenses amounted to 59 billion forint in 2017 and were 15.2% higher than in the previous year.

The growth in Operating expenses was partly driven by the increase in Personnel related expenses due to higher wages and salaries in line with higher number of FTE's from migrated Citi employees. Other administrative expenses also grew accordingly.

Depreciation amounted to 9.5 billion forint and increased by 50% compared to the previous year predominantly as a result of depreciation on various softwares developed under the Project Marlow (Citi) and Citi purchase price amortization.

Cost-income ratio improved from 54.5% (Q4 2016) to 54.1% (Q4 2017) mostly due to the higher operating income.

Other operating result declined by 7.7 billion forint in comparison to 2016. This was caused by the decreased provision allocation by 16 billion forint, The income from the FX settlement of CHF loans decreased even more significantly by 26 billion forint.

Risk provision for loans and off-balance exposures improved by 8 billion forint in 2017 compared to the previous year, predominantly due to a substantial reversal of impairment in the reporting period (2.8 billion forint).

At the end of 2017 Erste Hungary's capital adequacy was stable. The solvency ratio (19.24%) was higher than the statutorily required level and the capital position significantly strengthened. (Tier 1 deduction was calculated based on the hypothesis of 40 billion forint dividend proposed to the General Meeting not yet approved.)

OPERATIONS OF SUBSIDIARIES

Erste Hungary has a determinative role in Hungarian financial market. Erste Hungary's operation extends beyond the core services and as it includes investment services, leasing and factoring, as well as asset and property management services. To increase efficiency, Erste Hungary rationalized the group structure by merging certain activities and rationalizing its legal entities. The following tables that include the financial data of subsidiaries are based on individual financial statements of the subsidiaries in accordance with Hungarian accounting rules as audited figures are only available on consolidated basis.

Erste Befektetési Zrt.

The Company provides investment services.

The Company was founded in 1998. The volume of the products available for customers increased. The Company's goal is to provide high level accelerated services to customers in a simplified manner. In the branches of Erste Bank Hungary, online trading system ensures that the customer orders related to stock exchange and government bonds trading are serviced from any Erste Hungary location in Hungary.

Main financial data

in THUF	2016	2017	Change %
Total assets	156,410,493	163,175,387	4.33%
Total equity	10,907,160	12,714,344	16.57%
Issued capital	2,000,000	2,000,000	-
Profit or loss for the year	2,456,590	4,307,184	75.33%

Erste Lakáslízing Zrt.

Within Erste Hungary, one company provides financial leasing. On 1 January 2013, 5 financial companies were merged into the Bank (Erste Leasing Autófinanszírozó Zrt., Erste Leasing Eszközfinanszírozó Zrt., Erste Ingatlanlízing Zrt., Erste Faktor Zrt., and Magyar Factor Zrt.). The business goal was to achieve a high safety customer portfolio.

Erste Lakáslízing Zrt's main activity is leasing of property in use.

Main financial data

in THUF	2016	2017	Change %
Total assets	2,330,414	1,984,989	(14,8%)
Total equity	223,264	306,040	37,1%
Issued capital	53,000	53,000	-
Profit or loss for the year	(24,720)	82,776	434,9%

Erste Ingatlan Kft.

The Company's main activities are the following: property sale, property leasing and property management activities.

Main financial data

in THUF	2016	2017	Change %
Total assets	42,344,611	42,546,051	0,5%
Total equity	40,746,213	41,889,408	2,8%
Issued capital	210,000	210,000	-
Profit or loss for the year	1,074,962	1,143,193	6,3%

Sió Ingatlan Invest Kft.

Sió Ingatlan Invest Kft. is a project company that developed the SIÓ Shopping Center at Siófok city. The Company is owned by Erste Ingatlan Kft. in 100%.

Main financial data

in THUF	2016	2017	Change %
Total assets	3,340,432	3,312,005	0,85%
Total equity	3,085,841	3,041,009	1,45%
Issued capital	12,900	12,900	-
Profit or loss for the year	(197,184)	(44,833)	(77,26%)

Erste Lakástakarék Zrt.

Erste Lakástakarék Zrt. is a credit institution that deals with building society. Its license was issued on 29 September 2011 by the Financial Supervisory Authority, and the company started its activities on 17 October 2011.

Main financial data

in THUF	2016	2017	Change %
Total assets	57,205,948	75,071,125	31,2%
Total equity	5,722,919	3,740,401	(34,6%)
Issued capital	2,025,000	2,025,000	-
Profit or loss for the year	(1,727,477)	(1,982,518)	14,8%

Collat-real Kft.

The Company was founded on 10 March 2014 by Erste Bank Hungary Zrt. The Company's main activity is property management.

Main financial data

in THUF	2016	2017	Change %
Total assets	6,366,996	6,911,872	8,6%
Total equity	6,348,627	6,832,119	7,6%
Issued capital	3,000	8,000	166,7%
Profit or loss for the year	(41,935)	(23,739)	(43,4%)

Erste Jelzálogbank Zrt.

The Company was founded on 11 December 2015 by Erste Bank Hungary Zrt. The Company's main activity is refinancing mortgage loans.

Main financial data:

in THUF	2016	2017	Change %
Total assets	57,896,299	88,562,077	53,0%
Total equity	3,898,782	6,389,229	63,9%
Issued capital	3,000,000	3,005,000	0,2%
Profit or loss for the year	21,317	224,175	951,6%

QUANTITATIVE AND QUALITATIVE PERFORMANCE INDICATORS AND MARKERS FOR THE PROCESSES

Erste Hungary measures the quality of its internal operations through the main customer service channels (branch, Contact Center, electronic channels) and via the performance of its major customer service processes. The performance requirements for customer processes and service channels are defined following an assessment of customer needs. The Bank conducts regular researches: annual customer satisfaction and customer expectations surveys, mystery shopping in branches, and regular event-triggered surveys of branch visitors covering Channel Satisfaction, Customer Experience Index (CXI) and Net Promoter Score (NPS).

Customer needs and expectations are converted into indicators and measurable parameters. As a primary focus, the Bank built a system of indicators for business processes and channels in Erste Hungary, and conduct measurements to determine the performance of the processes. Processes are analyzed from the occurrence of customer needs to the satisfaction of those needs. The main indicators describing process capacities are: processing time, number of errors, service levels (for example the measuring of waiting times), or NetBank availability. Target values are defined for these indicators and the results of the regular measurements are compared to the pre-determined target values.

If the performance of a process remains below the target a detailed process analysis is conducted to identify root cause of non-compliance and development proposals are determined. This activity is performed weekly and monthly involving the areas affected by the process. If necessary, the Bank launches a project for improving the process involving action plan creation based on process improvement methodologies such as LEAN and Six Sigma

EMPLOYMENT POLICY

Erste Hungary's 2017 year-end headcount (3,047) was higher by 174 employees when compared to 2016 (2,873) Erste Hungary's average 2017 headcount was more than 100 people higher compared to 2016, primarily due to the integration of the acquired Citibank consumer business.

The average age of employees is 38 years with the average length of their employment being 6.2 years.

During 2017 Erste Hungary provided an opportunity for 126 trainees within the framework of a trainee program allowing the participants getting an overview of its operation and to acquire work experience. 4% of those participating in Erste Hungary's trainee program were subsequently hired as full time employees of Erste Hungary.

DESCRIPTION OF BUSINESS PREMISES

Erste Hungary's registered office has been at Népfürdő utca 24-26 since 1 September 2006. The modern office building hosts the organizational units of Erste Bank Hungary Zrt's head office and the subsidiaries. Erste Hungary has a nationwide branch network, which is controlled at regional level (Budapest 1., Budapest 2., North-East Hungary, South-East Hungary, East Hungary, West Hungary, Middle-West Hungary). The branches are listed in Annex No. 1.

EDUCATION POLICY

.During 2017 Erste Hungary continued employee development activities which ensure that all employees received an average of 4 days professional training. The main areas of development increasing professional knowledge such as completion of mortgage trainings, the internal process development, and the increase of the effectiveness of our sales and customer care activities. Erste Hungary focused on employee soft skills and English language skills development. Key training was provided to employees directly impacted by the integration of Citibank consumer business.

The Retail division continued the intensive training of newly on-boarded employees utilizing a new practice oriented system which granted a wide ranging system knowledge based education. The Bank established the foundations of our multi-level small business training system. Development Center days were established for our Branch Directors to define their individual development plans for 2018. Digital Channel and Private Banking focused on sales techniques and customer care development processes. Departments who are responsible for banking products and processes participated in special professional conferences and workshops.

The corporate division shared the development focus among sales techniques and customer experience courses, while strengthening cooperation and team cohesion. Day to day operation based on cultural values was an important focus supported by external presenters. Furthermore the Bank simplified a number of work processes to increase both efficiency and effectiveness.

Risk focused on improving cooperation and leadership development whilst launching the Risk Academy. Per the norm risk personnel participated in professional conferences in order to share experiences and gain insight to technical developments within their professional field.

IT division focuses on IT operational and business intelligence trends. In parallel the IT Academy program was successfully launched and utilized throughout 2017.

In relation Senior Management emphasis was placed on presentation skill development. A companywide cultural development program was launched supported by the managerial level and by pre-nominated 'change agents'. Finally, an organization-wide employee engagement survey was conducted with the results communicated to all.

CORPORATE SOCIAL RESPONSIBILITY

Erste was established 200 years ago allowing everyone participate in prosperity regardless of social status, nationality, religion, sexual orientation, or age. Protecting and expanding that prosperity is amongst our key objectives. Our future vision states "Our commitment to our customers and to Hungary is evident by our social responsibility acts beside our banking and investment services".

Therefore, in this complex world Erste Hungary seeks to be more than simply a business enterprise providing financial solutions - also offers solutions to life situations. In this context, Erste Hungary not only confirms its commitment to Hungary and Hungarian citizens through its banking and investment activities, but also through social responsibility functions implemented as a responsible employer.

The main pillars of Erste Hungary's Corporate Social Responsibility presence are the Hungarian activities of Erste Stiftung [Erste Foundation], the Good.bee program, and the bank's own CSR program dubbed "+1 tett" [+1 Act] as part of our volunteer program dubbed Közösségi csapatmunka [Community Team Work] was launched in 2015, actively involving our employees.

ERSTE Foundation in Hungary

Established in 2003 by Erste Österreichische Spar-Casse, the first savings cooperative in Austria founded in 1819, ERSTE Foundation (ERSTE Stiftung) is the biggest foundation in the savings cooperatives sector in Austria.

As the majority shareholder in Erste Group, ERSTE Stiftung is dedicated to foster social development in Central and Southeast Europe, realizing this commitment through projects initiated or sponsored in the scope of three programs: Social Development, Culture, and Europe.

ERSTE Stiftung

Further information: http://www.erstestiftung.org/

+1 tett program

"Our commitment to our customers and to Hungary is evidenced by our social responsibility acts besides our banking and investment services". It was in the spirit of this motto, taken from Erste's future vision, that our program "1+tett" ["1+Act"] was launched in 2014 designed to identify communities and projects that provide support to resolve matters of social importance, as well as in the topics of self-help and digitalization. At the same time, in addition to providing financial support, employees of Erste Hungary actively participated in the projects supporting the work of the selected organizations with their expertise.

+1 Act – Community teamwork

Taking the +1 Act program one step further, Erste Hungary - relying on its employees - launched a new volunteer program in 2015, dubbed Közösségi csapatmunka [Community Teamwork]. As part of the program employees of Erste Hungary volunteer to support implementing programs they themselves support. As an important aspect, the employees organize the program within community teamwork that they have proposed whilst Erste Hungary provides the time and the funding necessary for the program.

Within the framework of the program, diverse co-operation projects were conducted such as repainting the signals of trekking trails; supporting the financial education of children in state custody or living with foster parents; or organizing dragon boat events for underprivileged children. From 2015, nearly 800 Erste Hungary employees participated in roughly 50 projects.

In October 2016, the program was granted the special award for volunteering by Magyar Adományozói Fórum [Hungarian Donator Forum].

News of volunteering programs initiated as part of our Community Teamwork periodically posted on Erste Bank Hungary's Facebook page.

Additional cooperation projects

Virtuózok

"Winning a contest is merely the first step towards success. Afterwards, you have to manage your talent as skillfully as you manage your financial resources". Erste Hungary was not only the main sponsor of the TV talent show Virtuózok [Virtuoso] but also participated as a financial mentor to the young talents.

Singer Réka Kristóf won the main prize of the program provided by Erste Hungary (2 million forint) and was granted an opportunity to perform at New York's Carnegie Hall. The other two age group winners were granted 500,000 forint each per month for a year also provided by Erste Hungary.

Magyar Jégkorong Szövetség

Since September 2017 Erste Hungary sponsors the adult premier league ice hockey championship. The duration of the sponsorship is 3 years and the championship bears the name of Erste (Erste League).

The main goal is to support the national teams competing in the league; supporting the development of the next generation of ice-hockey players at grass roots level; promoting the sport of Ice Hockey within Hungary. Erste Bank not only provides sponsorship funds but also business acumen to the league.

Kékszalag Erste World Nagydíj

In 2016, Erste Hungary's new service Erste World debuted as naming sponsor to the 48th Kékszalag Nagydíj [Blue Ribbon Grand Prix]. Erste World's universe is similar to the world of sailing: the Blue Ribbon Grand Prix attracts those who appreciate real performance and real values. This is exactly what Erste World promises in the scope of financial services: help customers find real values; create real wealth from their assets based on the premise of property creates value and the foundations of both the family and the individual.

At the racing location Erste World offered special programs which including a lounge featured the values of the Lake Balaton region and a VIP section designed for VIP guests. Involving local partners, Erste World Club debuted at the venue, offering value-creating partnership to VIP customers and partners alike.

Mosoly Alapítvány

Since 2014 Erste Hungary has sponsored the initiative Mosoly Váltó [Smile Relay] launched by Mosoly Alapítvány [Smile Foundation]. This saw volunteering participants from Erste Hungary run 4 kilometres beside children who had successfully recovered from serious illness.

Further information: http://mosolyalapitvany.hu/hu/

Donut sale for Nemzetközi Cseperedő Alapítvány

Charity donut sales have been organized in cooperation with Nemzetközi Cseperedő Alapítvány [International Growing-up Foundation] at Erste Hungary's Headquarters since 2014 involving 'Fánki Donut'. In the sponsorship project Erste Hungary purchases the donuts being sold by the Foundation's staff at Erste Headquarters on a specific day. This project started with the sale of 300 donuts which rose to over 1,000 being sold in November 2017 in 90 minutes. The entire proceeds went to the Foundation which supports children living with the social challenges related to communication and skill development such as autism. In recent years, a total of nearly 3.5 million forint has been donated to the Foundation.

Erste Green

Erste Hungary is committed to environment protection taking responsibility for the environment and society in which we live and work. In addition to complying with the requirements defined by its parent company (such as reduction in CO2 emission, paper usage, electric energy consumption), Erste Hungary takes additional steps to make our organizational culture and operation greener and more environment-conscious thus expanding our commitment to corporate social responsibility.

ERSTE Green

Erste Green, a voluntary initiative of the employees was launched in early 2016 and primarily focused on educating and engaging all employees in protecting and enhancing the environment.

The initiative activities included wearing green clothes on Earth Day as well as providing a dedicated Erste Green tent on Erste Day whereby colleagues could participate in environment quizzes and measuring ecological footprint. A photo contest with an environmental theme was organized as well. Erste Green itself has embraced measures that both employees and the public could relate to. These measure included volunteering to collect trash at the Danube next to Erste Hungary's headquarter; clearing a trekking trail in the Pilis Mountainsand repainting the signage, implementing the ISO 50001 standard that endeavors to reduce energy costs and emission of gases that cause greenhouse effect.

Customers with disability

Erste Hungary continues to dismantle accessibility obstacles at retail branches in order to facilitate for customers living with disabilities and confined to wheelchairs to manage their banking matters as conveniently as possible. As a result of the program, the Bank has modified 80 out of its 117-unit branch network in Hungary to make them disabled-friendly by ensuring full access to the entrances and creating larger spaces inside the branches for easier maneuvering in the customer area. Going forward, all branch investments will be implemented with ease of access in mind unless physical or other obstacles arise.

ERSTE HUNGARY'S ENERGY MANAGEMENT

Erste Hungary places particular emphasis on environmental protection, sustainability and increasing its energy efficiency, both in the Head Office and Branch network.

Erste Hungary's head office buildings are "A" category office buildings and are constructed to the highest technical specification and utilize modern heating and cooling technologies as well as a building surveillance system. Motion and position sensors as well as energy-efficient LED light sources have been installed in several places in order to reduce energy consumption. During nights and weekends heating and air conditioning systems operate in energy-saving mode balancing the needs of the Bank with energy consumption reduction. All work stations are lit by natural light which supports the preservation of employee health and the aforementioned energy consumption reduction. With the use of mode switching adapted to business hours, the Bank ensures reduced energy consumption during periods of inactivity, which allows our entire branch network to operate with improved energy efficiency.

As part of our continuous improvements, Erste Hungary will replace energy supply equipment with more efficient devices that are able to meet the demand with greater efficiency thus minimizing the environmental impact.

In the spirit of environmental awareness, Erste Hungary also collect pre-selected waste types in Head Office including plastics, paper and municipal. It is intended to expand the scope of this recycling to the branch network.

8,000 MWh of green electricity was purchased in 2016 and 2017 which not only helped reduce CO2 emissions, but also indirectly facilitated the spread of innovative systems generating renewable energies. Erste Hungary is committed to continuing this activity and are planning to purchase a further 8,000 MWh of green electricity in 2018 for the operation of banking network.

In order to continuously maintain and improve the efficiency of energy management Erste Hungary introduced an energy management system that meets the requirements of the ISO50001 standard at the end of 2017. In line with internal needs and with the support of Erste Group ISO activities were expanded and included the introduction of ISO 14001 environment management system further enhancing the aforementioned commitment to environmental protection.

The development and renewal of our branch network are ensured by continuously improved standards and the innovative operation of our ISO systems. Artificial lighting is provided by energy-efficient fluorescent and LED lights. Lighting Erste logos and advertisements are based on a timer and with nightfall (in most locations) light is limited or reduced. The majority of newly installed equipment is energy efficiency class "A".

When selecting newly installed air conditioning equipment, Erste Hungary's preference is for VRV (heat pump) and inverter devices, which facilitate energy efficiency. Newly installed boilers are condensing which allow fuel savings and ultimately emission reduction.

In order to reduce paper consumption Erste Hungary introduced ATMs cash withdrawal without a paper based receipt. Recyclable environmentally friendly paper is purchased and utilized across all operations of Erste Hungary. This includes printing of bank statements as well as consumption within Head Office and the branch network.

In its internal correspondence Erste Hungary uses envelopes that can be addressed 24 times as well as recycled paper and stamps. Erste Hungary donates End Of Life usable personal computers as well as furniture to educational institutions and charitable foundations. Used copier and printer cartridges are recycled at the purchasing source.

In order to reduce the adverse environmental impact of transport the vehicle fleet is continuously re-configured based on current needs via the exchange and purchase of modern vehicles with energy-efficient engines. Initiative include the regular monitoring of emissions and fuel consumption as well as the provision of driving education related to ECO-Drive techniques via an ILearning system Erste Hungary provides space for the storage of 180 bicycles in the Head Office buildings for colleagues travelling to work by bicycle thus promoting health and environmentally friendly transportation.

EVENTS AFTER THE BALANCE SHEET DATE

At Erste Bank Hungary Zrt's Annual general meeting, to be held 26 April, proposal of dividend payment amounting to 40 billion forint is presented, that will be paid during 2018.

Budapest, 13 April 2018

Radován Jelasity
Chairman and Chief Executive Officer

Ivan Vondra
Chief Financial Officer

1. Annex No. 1 Branch network of the Bank as of 31 December 2017:

No.	Branch	City/town
1	Ajkai Branch	Ajka
2	Aréna Pláza Branch	Budapest
3	Árkád Üzletközponti Branch	Budapest
4	Bajai Branch	Baja
5	Balassagyarmati Branch	Balassagyarmat
6	Baross téri Branch	Budapest
7	Bartók-Házi Branch	Budapest
8	Béke téri Branch	Budapest
9	Békéscsaba, Andrássy úti Branch	Békéscsaba
10	Budaörsi Branch	Budaörs
11	Campona Branch	Budapest
12	Ceglédi Branch	Cegléd
13	Corvin negyed Branch	Budapest
14	Csepeli Branch	Budapest
15	Csornai Branch	Csorna
16	Danubius ház Branch	Budapest
17	Deák téri Branch	Budapest
18	Debrecen, Belvárosi Branch	Debrecen
19	Debrecen, Egyetemi Branch	Debrecen
20	Debrecen, Piac u. Branch	Debrecen
21	Debrecen, Vár u. Branch	Debrecen
22	Dombóvári Branch	Dombóvár
23	Dunaharaszti Branch	Dunaharaszti
24	Dunakeszi Branch	Dunakeszi
25	Dunaújvárosi Branch	Dunaújváros
26	Egri Branch	Eger
27	Egry József utcai Branch	Budapest
28	Érdi Branch	Érd
29	Erste World Branch Debrecen	Debrecen
30	Erste World Branch Győr	Győr
31	Erste World Branch Kecskemét	Kecskemét
32	Erste World Branch Kossuth tér	Budapest
33	Erste World Branch Mammut II.	Budapest
34	Erste World Branch Miskolc	Miskolc
35	Erste World Branch MOM Park	Budapest
36	Erste World Branch Pécs	Pécs
37	Erste World Branch Szeged	Szeged

No.	Branch	City/town
38	Erste World Branch Székesfehérvár	Székesfehérvár
39	Erste World Branch Vörösmarty tér	Budapest
40	Erste World Branch Zalaegerszeg	Zalaegerszeg
41	Erzsébet krt.8. Branch	Budapest
42	Esztergomi Branch	Esztergom
43	Eurocenter Branch	Budapest
44	Európa Torony Branch	Budapest
45	Fehérvári út 130. Branch	Budapest
46	Flórián téri Branch	Budapest
47	Gödöllői Branch	Gödöllő
48	Gyöngyösi Branch	Gyöngyös
49	Győr, Árpád úti Branch	Győr
50	Győr, Bajcsy-Zs. úti Branch	Győr
51	Gyulai Branch	Gyula
52	Hajdúböszörményi Branch	Hajdúböszörmény
53	Hajdúnánási Branch	Hajdúnánás
54	Hajdúszoboszlói Branch	Hajdúszoboszló
55	Hatvani Branch	Hatvan
56	Heltai Jenő téri Branch	Budapest
57	Hódmezővásárhelyi Branch	Hódmezővásárhely
58	Hűvösvölgyi Branch	Budapest
59	Jászberényi Branch	Jászberény
60	Kalocsai Branch	Kalocsa
61	Kálvin téri Branch	Budapest
62	Kaposvári Branch	Kaposvár
63	Karcagi Branch	Karcag
64	Kazincbarcikai Branch	Kazincbarcika
65	Kecskemét, Dobó körúti Branch	Kecskemét
66	Kecskemét, Kossuth téri Branch	Kecskemét
67	Keszthelyi Branch	Keszthely
68	Királyhágó téri Branch	Budapest
69	Kiskunfélegyházi Branch	Kiskunfélegyháza
70	Kiskunhalasi Branch	Kiskunhalas
71	Kispesti Branch	Budapest
72	Kisvárdai Branch	Kisvárda
73	Komáromi Branch	Komárom
74	Kossuth téri Branch	Budapest
75	Kőbányai Branch	Budapest

No.	Branch	City/town
76	Köki Terminál Branch	Budapest
77	Krisztina téri Branch	Budapest
78	Makói Branch	Makó
79	Mammut II. Branch	Budapest
80	Mammut II., emeleti Branch	Budapest
81	Mátészalkai Branch	Mátészalka
82	Mezőkövesdi Branch	Mezőkövesd
83	Miskolc, Bajcsy-Zs. u. Branch	Miskolc
84	Miskolc, Corvin u. Branch	Miskolc
85	Miskolc, Városház téri Branch	Miskolc
86	Mohácsi Branch	Mohács
87	MOM Park Branch	Budapest
88	Móri Branch	Mór
89	Mosonmagyaróvári Branch	Mosonmagyaróvár
90	Nagykanizsa, Belvárosi Branch	Nagykanizsa
91	Nyírbátori Branch	Nyírbátor
92	Nyíregyháza, Korzó Branch	Nyíregyháza
93	Nyíregyháza, Országzászló téri Branch	Nyíregyháza
94	Nyugati téri Branch	Budapest
95	Orosházi Branch	Orosháza
96	Paksi Branch	Paks
97	Pápai Branch	Pápa
98	Párisi utcai Branch	Budapest
99	Pécs, Diana téri Branch	Pécs
100	Pécs, Rákóczi úti Branch	Pécs
101	Pesterzsébeti Branch	Budapest
102	Pólus Irodaház Branch	Budapest
103	Private Banking Debrecen, Vár utcai Branch	Debrecen
104	Private Banking Győr, Bajcsy-Zs úti Branch	Győr
105	Private Banking Kecskemét, Kisfaludy utcai Branch	Kecskemét
106	Private Banking Miskolc, Bajcsy-Zsilinszky utcai Branch	Miskolc
107	Private Banking MOM SAS torony	Budapest
108	Private Banking Pécs, Rákóczi téri Branch	Pécs
109	Private Banking Szeged, Széchenyi téri Branch	Szeged
110	Private Banking Székesfehérvár, Palotai úti Branch	Székesfehérvár
111	Private Banking Zalaegerszeg, Ispotály közi Branch	Zalaegerszeg

No.	Branch	City/town
112	Rákóczi téri Branch	Budapest
113	Rákoskeresztúri Branch	Budapest
114	Salgótarjáni Branch	Salgótarján
115	Sárospataki Branch	Sárospatak
116	Sárvári Branch	Sárvár
117	Siófoki Branch	Siófok
118	Sopron, Előkapu Branch	Sopron
119	Szabadság téri Branch	Budapest
120	Szarvasi Branch	Szarvas
121	Százhalombattai Branch	Százhalombatta
122	Szeged, Kölcsey u. Branch	Szeged
123	Szeged, Széchenyi téri Branch	Szeged
124	Székesfehérvár, Budai úti Branch	Székesfehérvár
125	Székesfehérvár, Palotai úti Branch	Székesfehérvár
126	Szekszárdi Branch	Szekszárd
127	Szentendrei Branch	Szentendre
128	Szentesi Branch	Szentes
129	Szentgotthárdi Branch	Szentgotthárd
130	Szigetszentmiklós Auchan Branch	Szigetszentmiklós
131	Szolnok, Baross u. Branch	Szolnok
132	Szombathely, Mártírok tér Branch	Szombathely
133	Tatabányai Branch	Tatabánya
134	Tatai Branch	Tata
135	Teréz körúti Branch	Budapest
136	Thököly úti Branch	Budapest
137	Tiszaújvárosi Branch	Tiszaújváros
138	Törökszentmiklósi Branch	Törökszentmiklós
139	Újpesti Branch	Budapest
140	Váci Branch	Vác
141	Váci út 33. Branch	Budapest
142	Várpalotai Branch	Várpalota
143	Veszprém, Ádám Iván utcai Branch	Veszprém
144	Vörösmarty téri Branch	Budapest
145	Westend Branch	Budapest
146	Záhonyi Branch	Záhony
147	Zalaegerszeg,Ispotályközi Branch	Zalaegerszeg
148	Zirci Branch	Zirc

2. Annex No. 2: Erste Hungary Corporate Governance Report for year 2017

ERSTE HUNGARY

CORPORATE GOVERNANCE REPORT

FOR THE YEAR 2017

Under Section 95/B of Act C of 2000 on Accounting, ERSTE BANK HUNGARY Private Limited Company („the Company") hereby publishes its Corporate Governance Report.

The Company established its corporate governance system in a responsible, efficient and transparent manner, in accordance with the effective legislation applicable to companies and credit institutions, the recommendations from and expectations of the NBH (financial supervisor), keeping the interests of clients and Shareholders in mind.

The Company, as an issuer of certain listed securities prepared its corporate governance report – to ensure transparency and full comparability – in accordance with Corporate Governance Recommendations ("Recommendations" or "CGR") approved by the Board of Directors of the Budapest Stock Exchange Zrt. on 12 November 2012. The Company stresses however that the company is a credit institution operating as a private limited company, which applies the recommendations prepared for listed public limited companies with the derogations arising from its organization, activities and operations, as follows.

PART I

1. Operation of the Board of Directors, and a description of the division of responsibility and duties between the Board of Directors and the executive management

The Board of Directors as executive body of the Company governs the operation of the Company and its management in the framework set by legislation, the Company Statutes ("the Statutes") and the resolutions of the Company's General Meeting ("the General Meeting"), and by taking into account the recommendations from its Supervisory Board. It sets its own by-laws after seeking the opinion of the Supervisory Board.

The Board of Directors' competence is, under the Statutes and the by-laws of the Board of Directors, amongst others, the preparation of the reports under the Accounting Act[1] (including the proposal for a decision to deploy the profit after tax), the preparation of the budget, the approval of the Company's organizational structure, the approval of certain by-laws specified in the Credit Institution Act[2]; decision-making on the establishment and the dissolution of subsidiaries.

The Board of Directors consists of at least 3 members, elected by the General Meeting for a maximum of 5 years. The Board of Directors' members can be reappointed and dismissed by the General Meeting.

The members of the Board of Directors are employed by the Company (internal members), and persons not employed by the Company (external members).

The Chairman of the Board of Directors organizes the Board of Directors' work, ensures the efficient operation of the Board of Directors, represents the Board of Directors and carries out the tasks specified in the Statutes and the Board of Directors' by-laws in connection with the holding of the meetings and other tasks.

The meetings of the Board of Directors are held with the necessary frequency, but at least 4 (four) times a year. The Chairman of the Board of Directors is required to convene a Board of Directors meeting upon a written request from any member, specifying the reason for convening the meeting and the proposed agenda. The invitation must be sent in advance to the Board of Directors members as set out in the by-laws.

The Board of Directors has a quorum if more than half of its members are present. The Board of Directors makes its decisions with a simple majority of the members present, by taking into account Sections 13.9 and 13.10 of the Statutes unless it is otherwise provided by the relevant legislation or the Statutes.

The Board of Directors may pass its resolutions in writing (including via fax), teleconference or videoconference.

The internal members of the Board of Directors are the CEO, the Retail Deputy CEO, the CFO, the Deputy IT and Operations CEO and the Deputy Risk Management CEO, who govern the organizational units belonging to them in order to perform their duties.

The Chairman elected by the Board of Directors and employed by the Company (in 2017 and currently the CEO), and his deputies (in 2017 and currently the internal Board of Directors members) qualify as executive managers under the Credit Institution Act. The Board of Directors decides on the distribution of business activities amongst the executive directors and the rules for replacement. The Board of Directors' decisions are implemented by the executive directors.

The Board of Directors established, within its college, a Managing Board. The Managing Board is a body engaged in the everyday operational management of the Company, drafting the decisions and principles required for the everyday operation, the competence of which covers, amongst others: management and supervision of pending Company matters, making decisions required for the everyday business operation, issuing by-laws, decision on bringing court cases, provided that these decisions are not within the exclusive competence of the Board of Directors or other bodies under the internal by-laws or effective legislative provisions.

The members of the Managing Board are the Chairman of the Board of Directors, the CEO and the Deputy CEO's, who are also members of the Board of Directors. The CEO is the Chairman of the Managing Board.

The Managing Board convenes a Managing Board meeting at a weekly frequency. The Managing Board meeting has a quorum if more than half of its members are present. The Managing Board meeting adopts its decisions with a simple majority.

The Managing Board informs the Board of Directors of the measures and decisions made on a quarterly basis.

1. Act C of 2000 on Accounting
2. Act CXII of 2013 on Credit Institutions and Financial Enterprises

In year 2017 the Board of Directors' decisions related, amongst others, the following matters:

- reports of the management,
- Risk Management reports,
- the Company's organizational transformations,
- adoption of the amendments of internal regulations within the competence of the Board of Directors,
- preparation of the annual accounts and the related documentation,
- monitoring the inspection carried out by external authorities,
- decisions related to the Company's remuneration policy,
- decisions related to the implementation of Group level directives,
- decisions related to subsidiaries.

2. Introduction to the members of the Board of Directors, the Supervisory Board and the Managing Board

2.1. Members of the Board of Directors on 31 December 2017

Jelasity Radován Chairman of the Board of Directors, CEO (01.06.2011. -)

Jelasity Radován was born in Baja, finished his secondary school in Budapest. He obtained an MBA at the Finance Faculty of Illinois University in Chicago, after having acquired a degree in economics at the Belgrade University. He started his banking career at the Deutsche Bank in Frankfurt where he worked for four years as area manager responsible for Central-Eastern Europe. Later he participated, on behalf of McKinsey&Company in Frankfurt in banking projects in Germany, Poland and Bulgaria. As Vice President of the Banking Rehabilitation Agency he participated in the reorganization of the banking sector and in the launch of the privatization process of several large banks. He was the Governor of the National Bank of Serbia between 2004 and 2010, and earlier he was Deputy Governor at the Serbian Central Bank. As central banker, he played an important role in the consolidation of the Serbian banking sector and the insurance market, as well as in the strengthening of the regulatory and supervisory bodies; furthermore he played a key role in Serbia's negotiations with international financial institutions. Jelasity Radován as Chief Executive Officer of ERSTE BANK HUNGARY Zrt. – since June 2011 – beyond his responsibilities specified by the laws and by the Board of Directors by-laws, the Chief Executive Officer acts for the good of the Bank's business policies, is responsible for financial stability, manages the Bank, helps the Board of Directors in making decisions affecting the entire Bank, contributes to setting directions to the Bank's business policies with evaluation of local and foreign business and macro-economic environment. He manages and coordinates the Bank's Corporate Division, supervises the division's strategic and business planning and operation. He has been the member of the General Council in the Hellenic Financial Stability Fund in Athens since October 2016.

László Harmati Executive Director, Deputy CEO Retail (02.04.2013. -)

The professional economist started his career at the ITCB - Consulting and Training, then between 1998 to 1999 he was Head of Department of Entrepreneurship and Regulation in the Ministry of Finance. Between 1999 and 2002, as Head of Department of Regulation at the National Bank of Hungary, he played a leading role, amongst others, in the development and launching of the domestic trading book regulation and the implementation of the Basel capital rules in Hungary. From 2002 until early 2013, as Deputy CEO at FHB Mortgage Bank Nyrt, and as CEO from 2010 the supervision of the entire business area was his competence, thus he played a leading role in the management of the bank's business strategy. In 2006-2007 he undertook an active role in founding the FHB Bank Zrt where he fulfilled the position of the CEO. In 2010 and 2011, during the acquisition of Allianz Bank Zrt he was in charge of the merger, he is associated with the establishment of the new business model, managing the rationalization project, and the intensive retail online developments (netbank, netbroker, lead generation via the Internet). In 2012 he led several state schemes (NET, fixed exchange rate). He was a leading actor in the cost rationalization, the development of the new set of tools for housing subsidy, he is credited with the re-tuning of the collection protocols, and the increase of the branch and direct channels' cross-sale potential. László Harmati as Deputy CEO for Retail (Chief Retail Officer) of ERSTE BANK HUNGARY Zrt. – since April 2013 – manages and coordinates the retail division of the Bank, supervises the operation of the branch network, manages and supervises the sales of retail products and the customer service and telesales channel of the Bank.

Krisztina Zsiga Executive Director, Deputy CEO Risk management (06.11.2017. -)

She graduated in 1993 at the Manchester Metropolitan University. She has been working in risk management for more than 14 years, and her career advanced in this area. She obtained numerous experiences in various European countries. Between 1995 and 2007 she worked in the Inter-Európa Bank, in Citibank and in the CitiGroup in Budapest, Moscow, Norway, Prague, and London. She joined Erste Group Bank AG in January 2008 where she was working as Head of Retail Risk Management. Between 2013 and 2016 she was member of ERSTE Bank Hungary Zrt's Supervisory Board, before she had been elected as external Board member. In November 2017 Krisztina Zsiga was elected as Deputy CEO for Risk Management (Chief Risk Officer) of ERSTE BANK HUNGARY Zrt. She supervises the credit policies of the Bank's business lines, including the credit rating, collateral valuation and provisioning policies. She regularly reviews market risks, supervises the delegation of functions regarding credit clients and he holds responsibility for the safe and secure operation of the Bank, as well as for the legal activity of the entire Bank.

Ivan Vondra, Executive Director, Deputy CEO Finance (07.11.2015. -)

The economist professional used to work at the Czech subsidiary of the Erste Group, at Česká Sporitelna as Head of Accounting, Controlling and Business Intelligence since 2002. Before this he was also employed by a financial institution - between 1992 and 1996 he was Deputy CFO at International Commercial Bank, in Prague, thus he has a total of 20 years experience gained in the financial field. Ivan Vondra as Deputy CEO (Chief Financial Officer) of ERSTE BANK HUNGARY Zrt. –since November 2015 – is responsible for financial stability within the Bank's business policies and he supervises the Finance and Accounting, Controlling, ALM and Facility and Property Management and Procurement areas.

Tamás Foltányi, Executive Director, Deputy CEO IT and Operation (15.01.2016. -)

Studied in Budapest University of Technology at the Faculty of Electrical Engineering, Bank Management Program at the The International Training Center for Bankers Ltd. (Bankárképző). During his working carrier he used to have leading positions at Inter-Európa Bank and Creditanstalt. From 1999 till 2004 as a managing partner at PWC and IBM he was responsible for the Hungarian financial sector and services offered for them, then took over the management of the IBM Global Services businesses. From 2005 till 2015 he used to be Deputy Chief Executive Officer of the FHB Mortgage Bank Nyrt. Tamás Foltányi as Deputy CEO for IT and Operation (Chief Operating Officer) of ERSTE BANK HUNGARY Zrt. – since January 2016 - supervises the Bank's system development and organization tasks, manages and coordinates the IT and investment planning in the Bank, cooperates in operative decision making and supports the Bank's operation, holds responsibility for the Bank's IT and operation.

Dr. János Rudnay, external Board of Directors member (01.10.2004. -)

He graduated at the Vienna University' Law School in 1977. Between 1977 and 1994 he worked in management positions at various Philips affiliates. As of 1994 has was the CEO of the Pécs Brewery Rt. From 1995, he was the CEO of Reemtsma Debrecen Tobacco Plant Kft. Between 2001 and 2002 he was the member of SPB Investment Rt's advisory body. He has been a consultant to Erste Group Bank AG since September 2002. From 4 December 2003 he was external Board member of Postbank and Savings Fund Rt, then from 1 October 2004 he has been external Board member of ERSTE BANK HUNGARY Zrt.

Frederik Silzer external Board of Directors member (01.08.2005. -)

He started his career in 1988 at the die Erste österreichische Spar-Casse Bank, then from 1993 he worked at AVABANK in the control of affiliates, he was Executive Director at several Central European subsidiaries. In 1998 he joined Bank Austria AG (earlier operated as Creditanstalt AG) where he was in charge of coordinating subsidiaries, amongst other in Hungary. Since 2008 he has been in charge of coordinating Erste Bank der österreichischen Sparkassen AG in Central-Eastern Europe, including Hungary. He is responsible for numerous acquisition and integration projects.

Alexandra Habeler-Drabek, external Board of Directors member (06.12.2017. -)

She started her career in 1995 at the Creditanstalt-Bankverein Bank as Restrucuring and Workout Manager, in 1999 she became head of Risk Management Corporate & SME field. Between 2001 and 2010 she was in different leader positions in Unicredit Bank Austria. In 2010 she became head of Workout & Restructuring & Op-risk in Erste Bank Österreich, then she was the head of Operative Risk Management between 2012 and 2014. Between 2013 and 2016 she was the head of Group Enterprise-wide Risk Management in Erste Group Bank AG. Since 2017 she has been CRO at Slovenská sporiteľňa.

Zoltán István Marczinkó, external Board of Directors member (11.08.2016. -)

He graduated in 1988 at the Karl Marx University of Economic Sciences. At the beginning of his career he worked as the Head of Section for Production Organization in Dabas Printing House. He worked in the Budapest Bank Nyrt. as Lending Executive from 1992. Later he was the Head of Branch Network/Head of Central Branch at the HBW Express Savings Cooperative. He worked as the same position (branch manager) at the Budapest Bank from 2010 to the end of the year 2010, after that he was the head of the Corporate Business Center.

From 2013 he worked at the Széchenyi Kereskedelmi Bank Zrt. as Head of Acquisitions and Business Development. From 2014 he has been Deputy Secretary of State at the Ministry for National Economy, responsible for Key Corporate Relations.

Michael Neumayr, external Board of Directors member (14.09.2016. -)

He graduated in 1980 as doctor of law at the University of Vienna and subsequently obtained a diploma in International Relations at the Johns Hopkins University, Bologna Center.

He started his professional career in 1982 in international banking at Girozentrale Group, and held various management positions in the international division in Vienna, and the subsidiary in Zurich. In 1995 he joined Bank Austria Creditanstalt, Vienna, heading the International Finance and Syndications Department until 2002.

From 2002 - 2008 he was Executive Director and Member of the Board of Directors at the European Bank for Reconstruction and Development (EBRD) in London, representing Austria and five other shareholder countries, including Bosnia and Herzegovina, and Kazakhstan.

Since 2008, he is an independent business advisor, and member of supervisory boards of several banks and financial institutions.

2.2. Members of Supervisory Board on 31 December 2017

Dr. Manfred Wimmer, Supervisory Board member, Chairman of the Supervisory Board (01.09.2008. -)

He graduated in 1978 at the Law School of the Innsbruck University. His work experiences: 1982-1999: Creditanstalt, Wien, International Division. Since 1998 he has been working at ERSTE Bank der Oesterreichischen Sparkassen AG. between 1998-1999 as Head of International Marketing Department, between 1999-2002 as acquisition and integration Project Manager of Ceska Sporitelna, between 2002-2007 as Head of Strategic Holding Development Area, between 2007 and 2008 as President and Board Member of Banca Comerciala Romana, since 2008 as Board Member at Erste Group Bank AG responsible for Finance and Accounting and Performance Management. He retired as of 1 September 2013, but he is keeping the Chairman position of the Company's Supervisory Board.

Friedrich Rödler, Supervisory Board member (28.04.2012. -)

He graduated in 1975 at the Vienna Technical University (Mathematics and IT specialty), then obtained an academic degree at the Vienna School of Economics in 1976, then a second degree in "International relations" specialty. From 1976 to 1986 he was employed by Arthur Andersen & Co, then between 1986 and 1990 ha worked as a partner at GRT Robol & CO. He worked at PWC Austria between 2000- 2013 in various positions, then he retired as of 1 July 2013.

Gernot Mittendorfer, Supervisory Board member (02.12.2013. -)

He graduated at the Linz Law School in 1989. He started his career at the Erste Group in 1990 as Account Manager. From 1997 he joined Sparkasse Mühlviertel West Bank AG where he built the business in the Czech Republic as member of the Managing Board. In November 1999 he was moved to the Prague headquarter of Erste Group Bank AG where he was responsible for the retail area. As of 1 July 2000 he was appointed to member of Ceska Sporitelna's Managing Board. As of August 2004 he received a CEO mandate at the Salzburger Sparkasse Bank AG, then in 2007 at Ceska Sporitelna. Since January 2011 he has been a member of Erste Group Bank AG's Managing Board as Risk Management Director. As of September 2013 he is Finance Director at Erste Group Bank AG, and in this position he is responsible for the Group Accounting, Group Performance Management and Group Asset/Liability Management.

Maximilian Clary Und Aldringen, Supervisory Board member (22.03.2016. -)

He graduated at the Universitat Passau and European School of Management. He started his master's degree studies at London Business School for Executive MBA Degree in 2014.
During his working career he used to have several positions at Raiffeisen Zentralbank Österreich AG and Raiffeisen Bank International AG. From 2013 to 2014 he was employed at the Romanian subsidiary of Erste Bank Bank AG, Banca Comerciala Romana, as a Chief Operating Officer consultant. Since April 2014, he had been the senior manager of the area, which is responsible for the group strategy of Erste Group Bank AG, and since January 2015 he has been the head of the mentioned area.

dr. Alíz Zsolnai, Supervisory Board member (11.08.2016. -)

She graduated in 2002 at the University of Szeged. She passed Specialist Exam in Public Administration in 2004. In 2006 she spent three month internship in the HM Treasury. She finished her PhD studies in 2012. From 2002 she is a Government official in the Ministry for National Economy, where she worked as Deputy Head of Department in 2014, and from 2015 as Head of Department.

Lucyna Stanczak-Wuczynska, Supervisory Board member (28.02.2017. -)

She graduated in 1990 at the Warsaw School of Economics, then obtained a second degree in Economics and European Integration. She started her professional career in 1992 at Credit Agricole. Between 1998 and 2000 she was the Structured Finace Vice President of ABN Amro Bank Polska S.A. She joined the European Bank for Reconstruction and Development (EBRD) in 2000 in Poland, where she became Country Director. Since August 2014 she has been working at the headquarters of EBRD, located in London as Financial Institutions (EU Banks) Director.

Magdolna Nagy, Supervisory Board member, representing employees (01.02.2013. -)

She is Head of Custody Department

She graduated in 1990 at the Budapest School of Economics. She has 20 year experience in investment services. Since 1993 she developed the depository service activity in various domestic banks. Between 1993 and 1997, she was head of deposit management at Magyar Hitelbank, between 1997 and 2000 at CIB Central European International Bank Rt; at ERSTE BANK HUNGARY Zrt she has been Head of Custody Department since 2000.

Márta Marosvölgyi, Supervisory Board member, representing employees (13.05.2013. -)

She is Head of the Operating Control within IT and Operation.

She has a chartered accountant degree; and she graduated in 2002 at the Budapest Business School as economist and controller. She started her professional career in 2002 as accountant at Colling Ltd. Between 2003-2007 she worked as an expert at Citibank Hungary and Citibank Handlowy/Warsaw/Poland (current accounts, deposits, loans, insurance and investments) within Operation, and she supported the conversion of the Core Bank System. Between 2007-2010 she worked at HSBC's Polish bank as Financial Control Manager. She joined ERSTE BANK HUNGARY Zrt. in 2010 as Head of Section at the Operation Control; since January 2011 she leads the Operations Control Department at the Company.

Anna Kósa, Supervisory Board member, representing employees (11.08.2016. -)

She is Head of Compliance, AML and Fraud Prevention Department.

She graduated as lawyer in the University of Miskolc. She worked as compliance and legal executive at the beginning of her career at the Magyarországi Volksbank. She joined ERSTE BANK HUNGARY Zrt. in 2012 as compliance expert at the AML and Securities Compliance. She was responsible for performance of compliance functions related to the financial and investment service activities of the Bank and supervision of the relevant internal processes from compliance aspects. Later she was the Acting Head of Department. She is the Head of Compliance, AML and Fraud Prevention Department from May 2016.

2.3. Members of Managing Board on 31 December 2017

Jelasity Radován, Chairman of the Board of Directors, CEO, executive manager responsible for the Corporate Business

László Harmati, Executive Director, Deputy CEO Retail

Krisztina Zsiga Executive Director, Deputy CEO Risk management

Ivan Vondra Executive Director, Deputy CEO Finance

Tamás Foltányi: Executive Director, Deputy CEO IT and Operation

3. Description of the number of meetings held by the Board of Directors and the Supervisory Board in 2017

In 2017 both the Board of Directors and Supervisory Board held four meetings each.

The quorum of the bodies at the 2017 meetings of the Board of Directors and the Supervisory Board was ensured in each case.

4. The presentation of viewpoints considered when evaluating the work of the Board of Directors, the Supervisory Board, the Managing Board, as well as of the different members

The Company is a credit institution subject to the Credit Institution Act, where, in line with the legislative provisions the Remuneration and Nomination Committee appraised the members of the Board of Directors and the Supervisory Board. The appraisal criteria for members of the Committees are set out in the Remuneration Policy published by the Company, and its Fit & Properregulation, and other criteria in the Credit Institution Act. No further measures were made as a follow-up to this appraisal.

5. Report on the operation of individual committees

5.1. Supervisory Board

The Supervisory Board carries out the tasks delegated to it by the law or the Company's Statutes, in particular:

- it ensures that the Company's operation is in line with the relevant laws and general rules, including the Statutes of the Company and the resolutions of the General Meeting;

- it is consulted on the annual financial report; verifies the Company's annual, interim (or other extraordinary) and consolidated balance sheets and the proposals for the distribution of dividends, furthermore it submits the related proposals to the General Meeting;
- the Supervisory Board will analyze the reports about the Company's management;
- before submitting it to the General Meeting, it forms an opinion on the draft amendments to the Statutes;
- it makes a proposal to the General Meeting on the person and remuneration of the auditor of the Company;
- the Supervisory Board will examine and assess the basic principles of the Company's business policy and forms an opinion on the Company's business policy;
- the Supervisory Board will inform the General Meeting of the outcome of its supervisory and other activities;
- the Supervisory Board will check the performance of the Company's Board of Directors;
- forms a preliminary opinion on the budget of the Company, as well as any decrease or increase of the budget items in excess of 10%;
- forms a preliminary opinion on the interim balance-sheet of the Company, required for interim dividend payment, or other reasons;
- grants a preliminary approval to the Board of Directors proposal on interim dividend payment (Section 3:263 (2) of the Civil Code);
- forms an opinion on the Investment Directives;
- forms a preliminary opinion on the Directives setting out the internal rules for the right of signing of persons assuming obligations on behalf of the Company, and on the disclosure principles;
- forms an opinion on the election of the Chairman of the Board of Directors and the executive managers;
- adopts and reviews the principles of the Remuneration Policy and it is responsible for its verification; and
- manages the organization of the Internal Audit;
- it develops recommendations and proposals on the basis of the findings of the examinations carried out by the Internal Audit.

The Supervisory Board consists of at least 3 and at most 9 members, elected for five years by the General Meeting. The members of the Supervisory Board can be re-elected and recalled by the General Meeting at any time. As long as the annual average number of the Company's FTE employees exceeds 200 people, one third of the Supervisory Board members are appointed by the General Meeting on the basis of the nomination by the Work Council. The mandate of members representing employees ceases upon the termination of his/her employment.
The Chairman of the Supervisory Board can be invited to the meetings of the Board of Directors in a consultative capacity.

The Supervisory Board meets as frequently as it deems necessary, or upon the request from any Supervisory Board member, but at least four times a year.
The invitation letters and the proposals concerning the matters to be discussed at the Supervisory Board's meeting must be sent to the members as set out in the by-laws.
The Supervisory Board meeting has a quorum when at least two-third of the Supervisory Board members are present, with at least three members present other than those elected upon the appointment from the Works Council.

The Supervisory Board passes its decisions with a simple majority and the open vote by the members present. The opinion of the employee representatives must be recorded in each case. Where the employee delegate's opinion is unanimously different from the Supervisory Board's majority opinion, the minority position of the employees must be disclosed to the General Meeting.

The Supervisory Board may pass its resolutions in writing, (including fax), teleconference or video conference, as set out in the by-laws.

As a rule, the documents related to the Supervisory Board meetings and resolutions are drawn up in English.

In 2017 the Supervisory Board resolutions affected primarily the following issues:

- Quarterly Board of Directors reports, Remuneration Policy,
- Matters related with the governance of the Internal Audit; and
- the Company's organizational transformations,
- Preparation of the Annual Report and the related report, making proposals,
- making decisions related to the main changes related to subsidiaries,

5.2. Audit Committee

The Audit Committee is a sub-committee of the Supervisory Board that carries out advisory and consultancy tasks to the Supervisory Board as set out in its by-laws, and performs other tasks as set out by the Supervisory Board. Under the by-laws, the Audit Committee is competent in the following matters, amongst others:
tasks related to the report under the Accounting Act, the audit made by the auditors, the person of the auditor and the contract to be concluded with it, the evaluation of the financial reporting system; furthermore the Audit Committee performs tasks related to the operation of internal control, such as the activities of the internal independent audit organization and proposes measures in connection with the risk assessment and risk management systems.

The Audit Committee consists of 3 members, elected by the General Meeting from the independent members of the Supervisory Board not representing employees. At least one member of the Audit Committee must have an accounting or auditing qualification.

The Audit Committee holds meetings as necessary but it must have a minimum of two meetings a year. The meeting is convened by the Chairman, or in his absence by the Deputy Chairman. The meeting of the Audit Committee must be convened if initiated by the Supervisory Board by specifying the purpose of the meeting.

The Audit Committee has a quorum it is properly convened and at least two members are present. Otherwise the rules on the convention of the Supervisory Board apply. The Audit Committee passes its resolutions with unanimous decision.

The rules of the Audit Committee's operation are set out in its by-laws, adopted by the Supervisory Board. If all members of the Audit Committee agrees, its meeting can be convened electronically, via fax or the phone.

The Audit Committee may pass its resolutions by phone, fax or in any similar way.

The Chairman, or in the absence of the Chairman the Deputy Chairman makes an oral presentation to the Supervisory Board on the activity performed by or the meetings of the Audit Committee since the last oral or written report. Regular reports must be drawn up on the meeting of the Audit Committee and annexed to the material of the Supervisory Board meetings.

In 2017, the Audit Committee held four meetings, at all of them the Committee had a quorum.

In 2017 the Audit Committee primarily passed decisions on internal audit, the inspections carried out by the NBH at the Company, with the annual report and the auditor. The Board of Directors made no resolutions against the proposal from the Committee.

Members of the Audit Committee on 31 December 2017

Friedrich Rödler, Chairman

Gernot Mittendorfer, Deputy Chairman

Maximilian Clary Und Aldringen, member

5.3. Risk Governance Committee

The Risk Governance Committee is responsible for examining the reports related to the Company's risk profile, the risk management framework and risk management processes, and to supervise continuously the Company's solvency positions and compliance with the legislation and Erste Group level standards. It examines pricing principles, reviews remuneration guidelines in the context whether they comply with the institution's risk, capital and liquidity positions and the expected revenues.

The Committee receives information on every relevant development in risk management, reviews and discusses portfolio reports, and reports prepared on the risk management framework and related processes.

Three members of the Committee are delegated from amongst the external Board of Directors members.

Any member of the Board of Directors or the Supervisory Board, and the Deputy CEO Risk Management (Head of CRO, risk management areas in EBH) can also participate at the Committee's meetings but with no voting right, however, he/she can participate in the debates. Where the matters to be discussed require, the Chairman, or in his absence the Deputy Chairman can invite other Company employees or experts with appropriate expertise, to attend the Committee meeting with no voting right

The Risk Governance Committee holds its meetings as required but at least four times a year.

The Risk Governance Committee has a quorum if it is convened properly and at least two members are present. To pass a resolution on any matter discussed at the Committee's meeting at least two members voting for the decision is required. The members participating at the meeting via a teleconference or a video conference must be considered attending members.

The Risk Governance Committee may pass its resolutions via phone, fax or other similar ways.

The Chairman, or in his absence the deputy Chairman reports the Board of Directors on the activities completed by the Committee since the previous oral report and the meetings held. The Committee reports regularly to the Supervisory Board on its activities.

In 2017, the Risk Governance Committee held four meetings, at all of them the Committee had a quorum.

In year 2017 the Committee dealt with the matters within its competence, the amendment of risk management policies, and the effects of external events relevant for risk management.

Members of the Risk Taking - Risk Management Committee on 31 December 2017

Alexandra Habeler-Drabek, Chairperson

Frederik Silzer, Deputy Chairperson

dr. János Rudnay

5.4. Remuneration and Nomination Committee

The Remuneration and Nomination Committee performs the tasks specified in the Credit Institution Act for the Remuneration and Nomination Committee, as set out in its by-laws.

The Remuneration and Nomination Committee has three members, its members are delegated from amongst the external members of the Board of Directors.

The Committees by-laws sets out members of bodies, and employees that can attend the meetings of the Committee in consultative capacity. Depending on the agenda items, further guests, the Company's employees and external experts can be invited to the meetings of the Remuneration and Nomination Committee.

The Committee shall meet as required but at least twice a year. The Committee's meeting must be convened if initiated by the any of its members by specifying the purpose of the meeting.

The Committee may pass its resolutions by phone, fax or in any similar way.

The Committee has a quorum if at least two of its members are present. The Committee can pass decisions in any matter discussed at the meeting if at least two members vote for it. Members participating at a meeting by conference call or video conference shall be considered as being present.

In 2017 the Remuneration and Nomination Committee held two meetings; at both meetings the Committee had a quorum.

In 2017 the Committee mainly dealt with changes in the top management, remuneration issues, tasks within the Remuneration and Nomination Committee's competence and matters related to the amendment of the Remuneration Policy.

Members of the Remuneration and Nomination Committee on 31 December 2017:

dr. János Rudnay, Chairman

Frederik Silzer, Deputy Chairman

Alexandra Habeler-Drabek

6. Presentation of the system of internal controls and evaluation of the activity in the relevant period

The Company established and ensured at group level the system of internal controls, in line with the Credit Institution Act and the recommendation from NBH, and laid it down in the Company by-laws. The primary goal for operating internal controls is to facilitate the Company's prudent, efficient operation, in compliance with the legislation and by-laws, furthermore to assist the Company management in substantiated decision-making.

The basic pillars to the Company's internal control functions are the risk control function (risk management), compliance control function (compliance) and internal audit function. In the context of the financial process the work of the standing auditor is part of the internal control.

Internal Audit

The internal audit performs examination and evaluation of the activities of the Company and the subsidiaries and ancillary businesses subject to consolidated supervision with the Company. In this context it monitors compliance with legislative requirements, official orders and bylaws, whether the Company avails of the by-laws provided for by legislation and ensuring prudent operation, whether organizational units operate as provided for in the strategic objectives, it verifies the compliance and operation of business records, the outsourced activities and the content of the Remuneration Policy. As preventive activity, it contributes to projects as advisor, and forms an opinion when new products, by-laws, systems are introduced, if necessary.

The Internal Audit reports to the Supervisory Board, the Audit Committee and forward the reports to the Managing Board and the Board of Directors of the Company, and ensures that the reports are available to the financial supervisory authority.

The annual report of the Internal Audit on the implementation of the remuneration policy is also forwarded to the Remuneration and Nomination Committee.

The Supervisory Board governs the system of the independent internal audit and during this:

- it ensures that the Company has a comprehensive control system in place that is suitable for the effective operation,
- it adopts the annual audit plan of the internal audit organizational unit,
- It discusses at least half yearly the reports prepared by the internal audit and verifies the implementation of the required measures.
- if necessary, it assists the work of the internal audit by engaging an external expert,
- it makes proposals to change the headcounts of the internal audit organizational unit.

The Supervisory Board develops recommendations and proposals on the basis of the findings of the examinations carried out by the Internal Audit.

Decisions related to the establishment of an employment of the Head of Internal Audit, and his dismissal by the employer can be passed with the preliminary consent from the Supervisory Board.

Audit Committee

The sub-committee of the Supervisory Board, the Audit Committee also performs tasks related to the operation of the internal control system and the activities of the independent internal audit system, amongst others:

- discusses all internal audit related material prepared for the Supervisory Board,
- makes proposals for the Supervisory Board on the appointment, dismissal of the head of internal audit, the organization, headcount and main operational rules of the internal audit,
- makes proposals to the Supervisory Board in connection with the annual audit plan and the outcome of the internal audit activity, and
- proposes measures in the context of risk assessment and management systems.

Anti money-laundering and Compliance

The Anti-money laundering, the Compliance and Fraud Prevention areas of the Company carry out tasks related to the prevention of money laundering, international sanctions and fraud management and compliance risk detection and management tasks, on the basis of European Union and domestic legislation. In this context they draw up by-laws and procedures compliant with domestic and international legislation; in connection with their activities they perform inquiries and audits; perform similar professional supervision of group subsidiaries.

These areas of the Company prepare an annual comprehensive report on the anti money-laundering and compliance activity and state, to be approved by the Board of Directors of the Company.

Risk Management

The Company's risk management system is established to comply with legislative and supervisory requirements, in addition to the internal objectives of efficient and effective risk management. This system includes risk identification, the evaluation and analysis of their effects, drawing up plans for the required measures, and monitoring the efficiency of the risk management system. The management of the Company passes its resolutions being aware of significant risks.

Apart from the Risk Governance Committee, the Company set up further committees in order to ensure support to efficient decision making process and the multi-functional supervision (joint participation of various professional areas). Their main purpose is to establish risk management, the related principles, risk strategy and its alignment with the business strategy, its follow-up and monitoring, and to increase risk awareness. Among the key objectives of these committees are the implementation of mutual coordination between corporate and retail lending functions and internal management functions.

Risk management standards and expectations are set out in detail in the Company's risk management by-laws.

The Company publishes its Diclosure Report pursuant to the Capital Requirements Regulations ("Risk Management report") on its website each year, containing the organizational structure of risk management and the relevant risk management information at the Company in the relevant year, and the risk factors influencing the Company's operation and management. The Risk Management report can be accessed here at the Company website (www.erstebank.hu): https://www.erstebank.hu/hu/ebh-nyito/bankunkrol/erste-bank-hungary-zrt/vallalatiranyitas/hivatalaloskozzetetelek/2017/04/25/2016-evi-kockazatkezelesi-jelentes

Standing auditor

The Company has a standing auditor, appointed by the General Meeting, and registered in the Company Register.

The Company engaged with the audit of its 2017 annual report and consolidated annual report in line with the legislation in force PricewaterhouseCoopers Könyvvizsgáló Kft. (1055 Budapest, Bajcsy-Zsilinszky út 78.). Appointed auditor: Árpád Balázs (1124 Budapest, Dobsinai u. 1.; mother's name: Kozma Hedvig; Registration number with the Chamber: 006931).

The auditor performs its other tasks specified by the law (in particular in the Credit Institution Act); furthermore the Board of Directors and the Supervisory Board can request the auditor to perform special inspections and to draw up a report on them.

The Company regularly presents, in the Notes to the Annual Accounts, the fees charged by the auditor for the other certification services, for tax consultancy and other non-audit services charged in the reporting year (in addition to the fee charged by the auditor for the audit of the reports of the reporting year).

7. The company's disclosure policy

The Company is a private limited company that lays down its publication principles and procedures in its by-laws, in accordance with the legislative provisions. The by-laws set out principles and procedures which ensure that all relevant information about the Company and circumstances influencing its share price are disclosed accurately, in a timely fashion and in full.

- The Company regularly presents, in the Notes to the Annual Accounts, the fees charged by the auditor for the other certification services, for tax consultancy and other non-audit services charged in the reporting year (in addition to the fee charged by the auditor for the audit of the reports of the reporting year).
- The Company publishes its Risk Management report on its website each year, containing the organizational structure of risk management and the relevant risk management information at the Company in the relevant year, and the risk factors influencing the Company's operation and management.
- The Company publishes, together with its annual report, on its website the main remuneration data for the previous years, furthermore the summary of its current remuneration policy is available on its website.
- In its annual report the Company discloses information on the professional career of the members of the Board of Directors, the Supervisory Board and the Managing Board.

8. The Company's policy on trading by insiders

The Company is a private limited company, which manages the list of insider traders in line with the provisions of the Capital Market Act[3] and establishes its by-laws on insider trading.

9. Method of exercising shareholders' rights

The Company's main body is the General Meeting, where shareholders can exercise their participation and voting rights in person or via proxy.

The General Meeting is convened by the Board of Directors. The convention of the General Meeting can be initiated by one or several Shareholders or any Supervisory Board member in writing; its decision can be also initiated by the competent authority, the auditor and the court of registration. Invitation to the General Meeting is sent by the Board of Directors in writing (via the post, fax or, upon an express request, e-mail) to the Shareholders, at least thirty days before the date of the meeting.

The General Meeting can be attended via telecommunication devices (phone, videophone, online conference devices), in line with the rules set out in the Statutes.

The General Meeting can also pass resolutions in writing, without holding a meeting. In such a case a resolution is adopted when the last vote required to pass a resolution is received by the Board of Directors, provided that it is received within 30 days after the sending out of the draft resolution. Any Shareholder can request the convention of a face-to-face General Meeting within five working days following the receipt of the draft resolutions.

3 Act CXX of 2001 on the Capital Market

The General Meeting shall have a quorum if the Shareholders holding more than 75% of votes are present. A second or further General Meeting can be convened to a date at least three working days after the general meeting without a quorum, with the same agenda; in this case the General Meeting has a quorum where at least Shareholders holding at least 50% of the votes are present.

The General Meeting decides in matters belonging into his competence under legislation and the Statutes. The following are the exclusive competence of the General Meeting:

- amendments to the Statutes;
- increasing the share capital;
- appointment, dismissal, and setting the remuneration of the members of the Board of Directors:
- the election and dismissal of the members of the Supervisory Board or the Company's auditor, and establishing their remuneration;
- the election and dismissal of the members of the Audit Committee;
- adoption of the reports (activity report from the Board of Directors on the previous year's business, and the Supervisory Board's report on such a report), including the resolution on the use of the profit after tax;
- evaluation of the Board of Directors member's work in the previous business year, decision on the discharge to the Board members;
- decision to pay dividends end interim dividends;
- return of the Company's license for the activity;
- approval of the Supervisory Board's by-laws; and
- making decisions on all issues assigned to the competence of the General Meeting by law or the Statutes.

In the General Meeting's decision making voting procedures set out in the Civil Code[4] apply, except if any of these matters belong to the Reserved Competence of the General Meeting as set out in the Statutes, in which case the special voting rules as set out in the Statutes apply.

10. Remuneration statement

The Company publishes, together with its annual report, on its website the main remuneration data for the previous years, furthermore the summary of its current remuneration policy is available on its website.

The summary of the Remuneration Policy can be accessed here at the Company website (www.erstebank.hu): *https://www.erstebank.hu/hu/ebh-nyito/bankunkrol/erste-bank-hungary-zrt/vallalatiranyitas/javadalmazasi-politika*

4 Act V of 2013 on the Civil Code of Hungary

II. PART

Corporate Governance Report on Compliance with the Corporate Governance Recommendations

As part of the Corporate Governance Report, by completing the following tables, **the Company declares to what extent it applied in its own practice of corporate governance the recommendations and suggestions formulated in the different points of the CGR published by the Budapest Stock Exchange Ltd.**

By reviewing the tables, market participants may receive information on the extent to which the corporate governance practice of different companies meets certain requirements included in the CGR, and may easily compare the practices of the different companies.

Level of compliance with the Recommendations

The Company should indicate whether it applies the relevant recommendation or not, and in the case of a negative answer, it should provide the reasons for not applying the given recommendation.

A 1.1.1 The Board of Directors / Governing Body ensured that shareholders received access to information in time to enable them to exercise their rights.

Yes (Complies) No (Explanation)

A 1.1.2 The company applies the "one share - one vote" principle.

Yes (Complies) No (Explanation)

A 1.2.8 The company ensures that shareholders must meet the same requirements in order to attend at the general meeting.

Yes (Complies) No (Explanation)

A 1.2.9 Items on the general meeting agenda only include subjects which are correctly detailed and summarized clearly and unambiguously.

Yes (Complies) No (Explanation)

The proposals included the suggestions of the Supervisory Board and a detailed explanation of the effects of the decision.

Yes (Complies) No (Explanation)

A 1.2.10 Shareholders' comments on and supplements to the items on the agenda were published at least two days prior to the general meeting.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no legislative provision for such publication exists, due to the special characteristics of the operational form.

A 1.3.8 Comments on the items of the agenda were made available to shareholders simultaneously with registration at the latest.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no such legislative provision exists, due to the special characteristics of the operational form. In this year no shareholder comments were received to the agenda items of the General Meeting.

Written comments made on the items on the agenda were published two working days prior to the general meeting.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no legislative obligation for such publication exists, due to the special characteristics of the operational form.

A 1.3.10 The election and dismissal of executives took place individually and by separate resolutions.

Yes (Complies) No (Explanation)

A 2.1.1 The responsibilities of the Board of Directors / Governing Bodyinclude those laid out in Section 2.1.1 of CGR.

Yes (Complies) No (Explanation)

The Company is subject to the Credit Institution Act, which delegates the task under Subsection 2.1.1. d) of CGR, in accordance with the Remuneration Policy of the Company, to the Remuneration and Nomination Committee, otherwise the Board of Directors' tasks cover Section 2.1.1.

A 2.3.1 The Board of Directors / Governing Board held meetings regularly, at times designated in advance.

Yes (Complies) No (Explanation)

The Supervisory Board held meetings regularly, at times designated in advance.

Yes (Complies) No (Explanation)

The rules of procedure of the Board of Directors / Governing Board provide for unscheduled meetings and decision-making through electronic communications channels.

Yes (Complies) No (Explanation)

The rules of procedure of the Supervisory Board provide for unscheduled meetings and decision-making through electronic communications channels.

Yes (Complies) No (Please explain)

A 2.5.1 The Governing Board / Supervisory Board of the company has a sufficient number of independent members to ensure the impartiality of the board.

Yes (Complies) No (Explanation)

No Governing Board operates at the Company. The members of the Supervisory Board are independent of the management of the Company.

A 2.5.4 At regular intervals (in connection with the CGR) the Governing Board / Supervisory Board requested a confirmation of their independent status from those members considered independent.

Yes (Complies) **No (Explanation)**

No Board of Directors operates at the Company.

A 2.5.6 The company disclosed on its website the guidelines on the independence of the Governing Board / Supervisory Board, as well as the criteria applied for assessing independence.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no legislative obligation for such disclosure obligation exists, due to the special characteristics of the operational form.

A 2.6.1 Members of the Board of Directors / Governing Board informed the Board of Directors / Governing Board (Supervisory Board/Audit Committee) if they (or any other person in a close relationship to them) had a significant personal stake in a transaction of the company (or the company's subsidiary).

Yes (Complies) No (Explanation)

A 2.6.2 Transactions between board and executive management members (and persons in close relationship to them) and the company (or its subsidiary) were conducted according to general rules of practice of the company, but with stricter transparency rules in place.

Yes (Complies) No (Explanation)

Transactions which according to 2.6.2, fell outside the normal course of the company's business, and their terms and conditions were approved by the Supervisory Board.

Yes (Complies) **No (Explanation)**

The Company is a company subject to the Credit Institution Act, and according to this legislation, transactions concluded between the members of the bodies and the management (and persons related to them) and the Company (and its subsidiaries) are approved by the body/bodies specified by the by-laws, established in line with the requirements of the Credit Institution Act on internal lending and conflict of interests (decision of the Company's Board of Directors and the consent decision by the Supervisory Board, and of the subsidiary's Board of Directors and/or Supervisory Board).

A 2.6.3 Board members informed the Supervisory Board/Audit Committee (nomination committee) if they received an offer of Board membership or an offer of an executive management position in a company which is not part of the company group.

Yes (Complies) **No (Explanation)**

Pursuant to Sections 143-145 of the Credit Institution Act, any member of the Board of Directors shall immediately notify the Company Secretariat if he/she establish or terminate a membership in the management or any of the bodies of a company which is not a member of the Erste group. Such notification is examined by Compliance - in line with Section 13.12. of the Statutes of the Company and other by-laws - for potential conflicts of interests, and in the event of establishing the existence of the conflict of interests it calls the person concerned, by setting an appropriate deadline, to resolve the conflict of interest.

A 2.6.4 The Board of Directors / Governing Body established its guidelines on information flow within the company and the handling of insider information, and monitored compliance with those guidelines.

Yes (Complies) No (Explanation)

The Board of Directors / Governing Body established its guidelines regarding insiders' trading in securities and monitored compliance with those guidelines.

Yes (Complies) No (Explanation)

A 2.7.1 The Board of Directors / Governing Body formulated remuneration guidelines regarding the evaluation and remuneration of the work of the Board of Directors / Governing Body, the Supervisory Board and the executive management.

Yes (Complies) **No (Explanation)**

The Company is a company subject to the Credit Institution Act, and in line with the requirements of that legislation the principles of the Company's Remuneration Policy are adopted and reviewed by the Supervisory Board. In line with the legislative provisions the Remuneration and Nomination Committee appraised the members of the Board of Directors and the Supervisory Board.

The Supervisory Board formed an opinion on the remuneration guidelines.

Yes (Complies) **No (Explanation)**

The Company is a company subject to the Credit Institution Act, and in line with the requirements of that legislation the principles of the Company Remuneration Policy are adopted and reviewed by the Supervisory Board.

The guidelines regarding the remuneration for the Board of Directors / Governing Body and the Supervisory Board and the changes in those guidelines were approved by the general meeting, as a separate item on the agenda.

Yes (Complies) **No (Explanation)**

The Company is a company subject to the Credit Institution Act, and in line with the requirements of that legislation the principles of the Company Remuneration Policy are adopted and reviewed by the Supervisory Board and the Remuneration and Nomination Committee makes separate decisions .on the remunerations of the members of the Board of Directors and Supervisory Board.

A 2.7.2 The Board of Directors / Governing Body prepared an evaluation of the work it carried out in the given business year.

Yes (Complies) **No (Explanation)**

The Company is a company subject to the Credit Institution Act, and in line with the requirements of that legislation the appraisal of the Board of Directors' members work and performance is the responsibility of the Remuneration and Nomination Committee.

A 2.7.2.1 The Supervisory Board prepared an evaluation of the work it carried out in the given business year.

Yes (Complies) **No (Explanation)**

The Company is a company subject to the Credit Institution Act, and in line with the requirements of that legislation the appraisal of the Supervisory Board's members work and performance is the responsibility of the Remuneration and Nomination Committee.

A 2.7.3 It is the responsibility of the Board of Directors / Governing Body to monitor the performance of and determine the remuneration for the executive management.

Yes (Complies) No (Explanation)

The frameworks of benefits due to members of the executive management that do not represent normal practice, and the changes in those benefits were approved by the general meeting as a separate agenda item.

Yes (Complies) **No (Explanation)**

The Company is a company subject to the Credit Institution Act, and in line with the requirements of that legislation the frameworks of the remuneration applied by the Company and different from the usual are adopted and reviewed by the Remuneration and Nomination Committee, within the framework set by the principles of the Remuneration Policy.

A 2.7.4 The structure of share-incentive schemes were approved by the general meeting.

Yes (Complies) **No (Explanation)**

In year 2017 no share-incentive scheme existed at the Company.

Prior to the decision by the general meeting on share-incentive schemes, shareholders received detailed information (at least according to those contained in 2.7.4).

Yes (Complies) **No (Explanation)**

In year 2017 no share-incentive scheme existed at the Company.

A 2.7.7 The Remuneration Statement was prepared by the company and submitted to the general meeting.

Yes (Complies) **No (Explanation)**

The Company's Remuneration Policy is approved by the Supervisory Board, in line with the requirements of the Credit Institution Act, the summary of which is published by the Company. Furthermore, the Company prepares, under the CRR[5], and publishes in the framework of the Risk Management report its remuneration data for the reporting year; the Risk Management report is approved by the Managing Board of the Company.

The Remuneration Statement includes information about the remuneration of individual members of the Board of Directors / Governing Body, the Supervisory Board, and the executive management.

Yes (Complies) **No (Explanation)**

The Company prepares, under the CRR, and publishes in the framework of the Risk Management report its remuneration data for the reporting year regarding employees having significant effects on the risk profile of the Company (key persons); it contains remuneration data on an aggregate basis.

A 2.8.1 The Board of Directors / Governing Body or the committee operated by it is responsible for monitoring and controlling the company's entire risk management.

5 Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (CRR)

Yes (Complies) No (Explanation)

The Company, as a credit institution with at least 5 percent market share in terms of its balance sheet total, has a Risk Governance Committee established in line with the Credit Institution Act.

The Board of Directors / Governing Body request information on the efficiency of risk management procedures at regular intervals.

Yes (Complies) No (Explanation)

The Board of Directors / Governing Body took the necessary steps to identify the major risk areas.

Yes (Complies) No (Explanation)

A 2.8.3 The Board of Directors / Governing Body formulated the principles regarding the system of internal controls.

Yes (Complies) **No (Explanation)**

Risk control function, compliance control function and internal audit function can be classified as internal control functions. The system of internal controls, and the principles related to that system are established in accordance with the Credit Institution Act and Recommendation No. 5/2016 (VI. 06.) of NBH, approved by the bodies provided for in the by-laws and legislation. The bank level framework of risk control function and the application of risk taking principles (identification, measuring, mitigation, monitoring) and the rules of determination of risk bearing capacity calculation were defined within the framework of enterprise-wide risk management which was approved by the management and Board of Directors of the Company.The Compliance internal regulation comprising the provisions of compliance control function is to be approved by the management of the Company. Regarding internal audit system please see Sections 5.1., 5.2. and 6 of this corporate governance report.

The system of internal controls established by the executive management guarantees the management of risks affecting the activities of the company, and the achievement of the company's performance and profit targets.

Yes (Complies) No (Explanation)

A 2.8.4 When developing the system of internal controls, the Board of Directors / Governing Body took into consideration the viewpoints included in 2.8.4.

Yes (Complies) No (Explanation)

A 2.8.5 It is the duty and responsibility of the executive management to develop and maintain the system of internal controls.

Yes (Complies) No (Please explain)

Within the framework set out in the Credit Institution Act.

A 2.8.6 The company created an independent Internal Audit function which reports to the Audit Committee / Supervisory Board.

Yes (Complies) No (Explanation)

The Internal Audit reported at least once to the Audit Committee / Supervisory Board on the operation of risk management, internal control mechanisms and corporate governance functions.

Yes (Complies)

Regarding reporting of Internal Audit please see Section 6 of this corporate governance report.

A 2.8.7 The internal audit activity is carried out by the Internal Audit function based on authorization from the Audit Committee / Supervisory Board.

Yes (Complies) No (Explanation)

As an organization, the Internal Audit function is independent from the executive management.

Yes (Complies) No (Explanation)

A 2.8.8 The Internal Audit schedule was approved by the Board of Directors / Governing Body (Supervisory Board) based on the recommendation of the Audit Committee.

Yes (Complies) No (Explanation)

Under the Credit Institution Act, the internal audit plan is adopted by the Supervisory Board.

A 2.8.9 The Board of Directors / Governing Body prepared its report for shareholders on the operation of internal controls.

Yes (Complies) **No (Explanation)**

The operation of internal controls established in line with the Credit Institution Act is audited by the Internal Audit; the supervision of the Internal Audit is the competence of the Supervisory Board. Risk control and compliance control are subject to the governance by the member of the Company's risk management Board member (Deputy CEO Risk Management), which areas regularly report to the Board of Directors, to the Supervisory Board, and to the Managing Board.

The Board of Directors / Governing Body developed its procedures regarding the receipt, processing of reports on the operation of internal controls, and the preparation of its own report.

Yes (Complies) **No (Explanation)**

The Internal Audit, and in the cases specified in the Credit Institution Act, the Supervisory Board is responsible for developing the procedures related to the reports on internal controls in accordance with the Credit Institution Act.

A 2.8.11 The Board of Directors / Governing Body identified the most important deficiencies or flow in the system of internal controls, and reviewed and re-evaluated the relevant activities.

Yes (Complies) No (Explanation)

A 2.9.2 The Board of Directors / Governing Body, the Supervisory Board and the Audit Committee were notified in all cases when an assignment given to the auditor may have resulted in significant additional expense, caused a conflict of interest, or affected normal business practices significantly in any other way.

Yes (Complies) No (Explanation)

A 2.9.3 The Board of Directors / Governing Body informed the Supervisory Board of any assignment given to the external auditor or an external advisor in connection with any event which held significant bearing on the operations of the company.

Yes (Complies) No (Explanation)

The Board of Directors / Governing Body pre-determined in a resolution what circumstances constitute "significant bearing" on the operation of the Company.

Yes (Complies) **No (Explanation)**

The Company classifies economic transactions as „significant bearing" actions according to the finance ministry decree of 24/2008. (VIII. 15.).

A 3.1.6 On its website, the company disclosed duties delegated to the Audit Committee, as well as the committees targets, rules of procedure, composition (indicating the name, brief biography and the date of appointment of members).

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes significant part of the above data in this Corporate Governance Report.

A 3.1.6.1 On its website, the company disclosed duties delegated to the Nomination Committee, as well as the committees targets, rules of procedure, composition (indicating the name, brief biography and the date of appointment of members).

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes significant part of the above data in this Corporate Governance Report.

A 3.1.6.2 On its website, the company disclosed duties delegated to the Remuneration Committee, as well as the committees targets, rules of procedure, composition (indicating the name, brief biography and the date of appointment of members).

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes significant part of the above data in this Corporate Governance Report.

A 3.2.1 The Audit Committee / Supervisory Board monitored the efficiency of risk management, the operation of internal controls, and the activity of the Internal Audit.

Yes (Complies) No (Explanation)

A 3.2.3 The Audit Committee / Supervisory Board received accurate and detailed information on the work schedule of the Internal Auditor and the independent auditor, and received the auditor's report on problems discovered during the audit.

Yes (Complies) No (Explanation)

A 3.2.4 The Audit Committee / Supervisory Board requested the new candidate for the position of auditor to submit the disclosure statement according to 3.2.4.

Yes (Complies) No (Explanation)

A 3.3.1 There is a Nomination Committee operating at the company.

Yes (Complies) No (Explanation)

A 3.3.2 The Nomination Committee provided for the preparation of personnel changes.

Yes (Complies) No (Explanation)

The Nomination Committee reviewed the procedures regarding the election and appointment of members of the executive management.

Yes (Complies) No (Explanation)

The Nomination Committee evaluated the activity of board and executive management members.

Yes (Complies) No (Explanation)

The Nomination Committee examined all the proposals regarding the nomination of board members which were submitted by shareholders or the Board of Directors / Governing Body.

Yes (Complies) **No (Explanation)**

The Remuneration and Nomination Committee examines, in accordance with the Credit Institution Act, the nomination of Board of Directors members, Executive Directors and Supervisory Board members.

A 3.4.1 There is a Remuneration Committee operating at the company.

Yes (Complies) No (Explanation)

A 3.4.2 The Remuneration Committee made a proposal for the system of remuneration for the boards and the executive management (individual levels and the structure of remuneration), and carries out its monitoring.

Yes (Complies) No (Explanation)

A 3.4.3 The remuneration of the executive management was approved by the Board of Directors / Governing Body based on the recommendation of the Remuneration Committee.

Yes (Complies) No (Explanation)

The remuneration of the Board of Directors / Governing Body was approved by the general meeting based on the recommendation of the Remuneration Committee.

Yes (Complies) **No (Explanation)**

In accordance with the requirements of the Credit Institution Act, the employer's rights with regard to Executive Directors are exercised by the Board of Directors of the Company; the remuneration of the Board of Directors members is approved by the General Meeting.

The Remuneration Committee also monitored the share option, cost reimbursement and other benefits in the remuneration system.

Yes (Complies) No (Explanation)

A 3.4.4 The Remuneration Committee made proposals regarding remuneration guidelines.

Yes (Complies) No (Explanation)

A 3.4.4.1 The Remuneration Committee made proposals regarding the remuneration of individual persons.

Yes (Complies) No (Explanation)

A 3.4.4.2 The Remuneration Committee reviewed the terms and conditions of contracts concluded with the members of the executive management.

Yes (Complies) No (Explanation)

A 3.4.4.3 The Remuneration Committee ascertained whether the company fulfilled its disclosure obligations regarding remuneration issues.

Yes (Complies) No (Explanation)

A 3.4.7 The majority of the members of the Remuneration Committee are independent.

Yes (Complies) No (Explanation)

The Company is a credit institution subject to the Credit Institution Act whose Remuneration and Nomination Committee is established with the composition set out by the law, and its members are delegated from amongst the external members of the Board of Directors (who are not in employment relationship with the Company).

A 3.5.1 The Board of Directors / Governing Body disclosed its reasons for combining the Remuneration and Nomination Committees.

Yes (Complies) **No (Explanation)**

The Credit Institution Act applicable to the Company does not provide for a publication on the justified nature of this combination.

A 3.5.2 The Board of Directors / Governing Body carried out the duties of the Nomination Committee and disclosed its reasons for doing so.

Yes (Complies) **No (Explanation)**

There is a Remuneration and Nomination Committee operating at the Company.

A 3.5.2.1 The Board of Directors / Governing Body carried out the duties of the Remuneration Committee and disclosed its reasons for doing so.

Yes (Complies) **No (Explanation)**

There is a Remuneration and Nomination Committee operating at the Company.

A 4.1.1 In its disclosure guidelines, the Board of Directors / Governing Body established those principles and procedures which ensure that all relevant information about the operations of the company and circumstances influencing its share price are disclosed and made available accurately, in a timely fashion and in full.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, and its sets out its disclosure principles and procedures in accordance with the laws (primarily the Civil Code, the Credit Institution Act, the Capital Markets Act[6], Act on Investment Services[7], Act C of 2000 on Accounting and Decree 24/2008 (VIII.15.) of the Minister of Finance) in its by-laws, ensuring that all material information affecting the price of its securities is disclosed precisely, fully and in a timely manner.

A 4.1.2 The company ensured in its disclosure activities that all shareholders and market participants were treated equally.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, where arrangement made by the three Shareholders of the Company and the provisions of the Statutes apply, regarding disclosure towards market participants please see Section 7 of present Corporate Governance Report.

A 4.1.3 The company's disclosure guidelines include the procedures governing electronic, on-line disclosure.

Yes (Complies) No (Explanation)

The company develops its website taking into consideration disclosure guidelines and the provision of information to investors.

Yes (Complies) No (Explanation)

The Company is private credit institution, who develops its website in line with its ownership structure, by keeping in mind the disclosure principles in accordance with the standards in the Credit Institution Act and the Act on Investment Services and the proper information of customers and investors.

A 4.1.4 The Board of Directors / Governing Body assessed the efficiency of disclosure processes.

Yes (Complies) No (Explanation)

6 **Act CXX of 2001 on Capital Markets**

7 Act CXXXVIII of 2007 on investment companies and commodity exchange service providers as well as on the rules of the activities to be carried out by them

A 4.1.5 The company published its corporate events calendar on its website.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, for which no legislative provision on such publication obligation takes place. The Company publishes the material content of resolutions passed by the General Meeting.

A 4.1.6 In the annual report and on the website of the company, the public was informed about the company's corporate strategy, its main business activities, business ethics and its policies regarding other stakeholders.

Yes (Complies) No (Explanation)

A 4.1.8 In the annual report the Board of Directors / Governing Body disclosed the character and size of any other assignments given by the company or its subsidiaries to the auditing firm responsible for auditing the financial statements.

Yes (Complies) No (Explanation)

A 4.1.9 In the annual report and on the website the company discloses information on the professional career of the members of the Board of Directors / Governing Body, the Supervisory Board and the executive management.

Yes (Complies) No (Explanation)

A 4.1.10 The company provided information on the internal organization and operation of the Board of Directors / Governing Body and the Supervisory Board.

Yes (Complies) No (Explanation)

The Company is a private limited company that provides public information on the compositions and operations of the Board of Directors and the Supervisory Board as set out in this Corporate Governance Report.

A 4.1.10.1 The company provided information on the criteria considered when evaluating the work of the Board of Directors / Governing Body, the executive management and the individual members thereof.

Yes (Complies) No (Explanation)

A 4.1.11 In the annual report and in the Remuneration Statement on the company's website, the company informed the public about the applied remuneration guidelines, including the remuneration and fees provided for members of the Board of Directors / Governing Body, the Supervisory Board and the executive management.

Yes (Complies) **No (Explanation)**

The Company publishes the summary of its Remuneration Policy, and in the framework of the Risk Management report its remuneration data for the reporting year, in accordance with the reporting year.

The Company does not publish the remuneration declaration set out in the Commission Recommendation 2004/913/EC.

A 4.1.12 The Board of Directors / Governing Body disclosed its risk management guidelines, including the system of internal controls, the applied risk management principles and basic rules, as well as information about major risks.

Yes (Complies) No (Explanation)

The Company publishes its Risk Management report with the above content, in line with the requirements of the Credit Institution Act.

A 4.1.13 In order to provide market participants with information, the company publishes its report on corporate governance at the same time that it publishes its annual report.

Yes (Complies) No (Explanation)

A 4.1.14 The company discloses its guidelines governing insiders' trading in the company's securities on its website.

Yes (Complies) **No (Explanation)**

The Company is a private limited company whose securities are not traded publicly.

The company published in the annual report and on its website ownership in the company's securities held by the members of the Board of Directors / Governing Body, the Supervisory Board and the executive management, as well as any interests held in share-incentive schemes.

Yes (Complies) **No (Explanation)**

The Company is a private limited company, whose shares are owned by three Shareholders, Erste Group Bank AG, EBRD and the Hungarian State.

A 4.1.15 In the annual report and on its website, the company disclosed any relationship between members of the Board of Directors / Governing Body and the executive management with a third party, which might have an influence on the operations of the company.

Yes (Complies) **No (Explanation)**

The Company is a private limited company that treats and keeps record of the relationships between the Board of Directors and the management with third parties that can influence the operation of the Company as set out in its by-laws, in accordance with the Credit Institution Act.

Level of compliance with the Suggestions

The company should indicate whether the relevant suggestion of the CGR is applied or not (– Yes / No)

In view of the fact that the FT Recommendation contains proposals on listed public limited companies established in Hungary, the Company, as private limited company does not apply most of them. Below we list the proposals followed by the Company

J 1.1.3	The company has an investor relations department.	<u>Yes</u> / No
J 1.2.2	The company's articles of association are available on the company's website.	<u>Yes</u> / No
J 2.1.2	The rules of procedure define the composition of the Board of Directors / Governing Body and all procedures and protocols for the preparation and holding of meetings, the drafting of resolutions and other related matters.	<u>Yes</u> / No
J 2.2.1	The rules of procedure and the work schedule of the Supervisory Board gives a detailed description of its operation and duties, as well as procedures and processes which the Supervisory Board followed.	<u>Yes</u> / No
J 2.3.2	Board members had access to the proposals of a given meeting at least five days prior to the board meeting.	<u>Yes</u> / No
J 2.3.3	The rules of procedure regulate the regular or occasional participation at board meetings of persons who are not members of the boards.	<u>Yes</u> / No
J 2.4.3	Newly elected, non-executive board members were able to familiarize themselves with the structure and operations of the company, as well as their duties as board members through a tailored induction programme. Note: the Company has no induction programmes	<u>Yes</u> / No
J 2.5.2	The separation of the responsibilities of the Chairman of the Board of Directors / Governing Body from those of the Chief Executive Officer has been outlined in the basic documents of the company.	<u>Yes</u> / No

J 2.5.5	The company's Supervisory Board has no member who held a position in the Board of Directors / Governing Body or the executive management of the company in the three years prior to his nomination.	Yes / No
J 2.7.5	The development of the remuneration system of the Board of Directors / Governing Body, the Supervisory Board and the executive management serves the strategic interests of the company and thereby those of the shareholders.	Yes / No
J 2.7.6	In the case of members of the Supervisory Board, the company applies a fixed amount of remuneration and does not apply a remuneration component related to the share price.	Yes / No
J 2.8.2	The Board of Directors / Governing Body developed its risk management policy and regulations with the cooperation of those executives who are responsible for the design, maintenance and control of risk management procedures and their integration into the company's daily operations.	Yes / No
J 2.8.10	When evaluating the system of internal controls, the Board of Directors / Governing Body took into consideration the aspects mentioned in Section 2.8.10 of CGR.	Yes / No
J 2.8.12	The company's auditor assessed and evaluated the company's risk management systems and the risk management activity of the executive management, and submitted its report on the matter to the Audit Committee / Supervisory Board.	Yes / No
J 2.9.4	The Board of Directors / Governing Body may invite the company's auditor to participate in those meetings where it debates general meeting agenda items.	Yes / No
J 2.9.5	The company's Internal Audit function co-operated with the auditor in order to help it successfully carry out the audit.	Yes / No
J 3.1.4	The company's committees are made up of members who have the capabilities, professional expertise and experience required to perform their duties.	Yes / No
J 3.1.5	The rules of procedure of committees operating at the company include those aspects detailed in Section 3.1.5 of CGR.	Yes / No

J 3.2.2	The members of the Audit Committee / Supervisory Board were fully informed about the accounting, financial and operational peculiarities of the company.	Yes / No
J 3.3.3	The Nomination Committee prepared at least one evaluation for the chairman of the Board of Directors / Governing Body on the operation of the Board of Directors / Governing Body and the work and suitability of the members of the Board of Directors / Governing Body.	Yes / No
J 3.4.5	The Remuneration Committee prepared the Remuneration Statement.	Yes / No
J 4.1.4	The disclosure guidelines of the company at least extend to those details contained in Section 4.1.4 of CGR.	Yes / No
J 4.1.7	The company's financial reports followed IFRS guidelines.	Yes / No
J 4.1.16	The company also prepares and releases its disclosures in English.	Yes / No

3. Annex No. 3 Non-financial statement

Non-financial statement

As in Erste Bank Group AG (Erste Group) the active engagement beyond classic banking activity and the integration of sustainability principles into basic operation and into corporate culture are integral parts of Erste Hungary (Group). In this context beyond financial efficiency, Group is continuously looking for opportunities to be an active member of the society in which it operates to support reaching our common goals and successes.

Environmental protection

The main principle of Erste Group's environment strategy and interpretation of sustainability are based on the central message of "Our common future", which was released by the UN's Brundtland Commission in 1987: "*sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.*"

In 2016 Erste Hungary implemented Energy management systems (ENIR), which is based on the standard requirements of MSZ EN ISO 50001:2012, which implementation was a legal obligation. After this Erste Hungary started its Environmental management systems (KIR) on 5 June 2017 in accordance with MSZ EN ISO 14001:2015 standard. Both KIR and ENIR are inseparable parts of the currently existing Group regulations in force. These two internal regulations are the SZT540/2016 Energy Management Policy and the SZT460/2016 Environmental Management Policy, the manuals of KIR and ENIR are obligatory and inseparable annexes of these. The surveillance of the operation of ISO systems are done by internal audit.

In 2017 compared to 2016 Erste Hungary reached a 3.3% energy consumption decrease. If we extract the consumption of the five new branches taken over from Citi Bank in February 2017 the consumption decreased by 5.9% on a comparable basis. This directly resulted in 47 863.2 kg CO_2 emission reduction in 2017.

Erste Green, a voluntary initiate of our employees for the purpose of implementing environment protection objectives, was launched early 2016. The primary aim is to draw attention to the topic in Erste Hungary along with education and enhancing our colleagues' engagement in our environment (e.g. garbage collection, car-free day, etc.).

Social and employment questions, respecting human rights

The basis for Group's approach to diversity and inclusion lies in the Founding Document of the Erste österreichische Spar-Casse from 1819, which states: *"No age, no gender, no social status, nor nationality should be excluded from the benefits which are provided to all the depositors of the Savings Bank."*.

Group´s diversity and inclusion principles aim to provide a work environment free of discrimination and harassment and valuing the work and worth of each and every person, regardless of gender, age, marital status, sexual orientation, disability, race, skin color, religious or political affiliation, ethnic background, nationality, citizenship or any other aspect unrelated to employment.

In 2017 Group has adopted a Diversity and Inclusion Policy which sets out the diversity and inclusion principles of the organization, defines what diversity and inclusion means for Group and outlines respective roles and responsibilities of the diversity management, and declares a commitment to develop, implement diversity and inclusion targets and strategy. The commitment to these values in Erste Group was institutionalized by the appointment of the Head of Diversity, whose task is to form the Group level diversity policy, to specify the aims and steps, and to follow-up the implementation.

Diversity management as understood by the Group refers to organizational actions that are designed to (i) better understand the needs of our diverse customer base and provide them with products and services that reflect those needs; (ii) leverage social, cultural, gender and age differences to improve performance and results; and (iii) ensure organizational effectiveness by integrating diversity in staffing.

In 2017 Group's Managing Board adopted Group's diversity strategy for 2018-2019 which sets the focus and priorities of the diversity and inclusion endeavors within the organization. Being a family-friendly company is one of the main pillars of Group ´s diversity strategy. Group has also committed to ensure a healthy working environment that allows employees to find a balance between professional and private life.

The Remuneration and Nomination Committee on its session in November 2014 specified that in Group level the share of women participating in leading bodies and in senior management positions need to reach 35% until 2019. To achieve this goal the Bank organizes the leadership replenishment programs, the carrier management programs and other interior programs considering the diversity aims. Furthermore Group launched ErsteNő (Erste Women - Women's Club) which primarily focuses on promoting a family friendly organization, the work-life balance of working women and supporting mothers returning from maternity leave. They also support women advance their careers and organize mentoring programs. ErsteNő played an active role in defining Erste Hungary´s diversity strategy and priorities for 2018-2019.

Inclusion and accessibility are an integral part of Group's diversity strategy. Various initiatives aim at creating both a more inclusive environment for employees with disabilities as well as ensuring barrier-free banking for clients with disabilities. Accessibility for employees and clients is also one of the top 5 diversity priorities identified by the employees in the 2017 diversity survey. Group committed in its diversity strategy to explore further opportunities to hire and retain employees with disabilities and enhance our services to clients with disabilities.

In 2017 Group has signed again the Hungarian Diversity Charter, the Hungarian version of the European Diversity Charter, by which it has re-enforced its committed to respect equality, to create a diverse organizational culture and to continuously develop the employee relationships, the partnerships with customers and the business environment to promote anti-discrimination and a long-term sustainable culture, which is in line with the values described in the Charter.

Further employment related questions can be found in the chapter of Employment Policy.

Fight against corruption and blackmailing

Erste Group pays close attention to the proper operation of compliance activity, to the formation of wide scope of competence, to the fair and ethical operation, to prevent corruption and to the compliance with legal requirements and norms. To ensure the Group level compliance Erste Hungary is supported by several Group Policies to cover the highest level legal compliance. Accordingly, Group has proper regulatory documents to maintain its duties from which the most important are: compliance policy, Ethical Codex, conflict of interest principles, managing conflicts of interest, internal credit policy, whistleblowing policy, money laundering and terrorist financing prevention policy, anti-corruption policy, sanctions and embargoes policy, anti-fraud policy. During the formulation of applicable compliance norms in Group the compliance to the recommendations of international professional organisations and of the National Bank of Hungary was in strong focus.

During its operations (including preventing money laundering and terrorist financing, anti-fraud, general compliance and compliance operations related to supplying investment services) compliance consistently applies a risk-based approach and performs its activities along an annual plan. During the preparation of this plan Erste Hungary evaluates all of its organizational units and processes for compliance risk perspective and form its work and control plan accordingly. During the preparation of the work plan the area puts a great emphasis on taking into account the changes of legal obligations, on the evaluation of international tendencies and on the implementation of international standards.

The compliance area according to the work plan makes further risk assessments and works out an action plan to decrease and to abolish the revealed risks. The Compliance, Anti-Money Laundering & Fraud Prevention reports quarterly about its activity, about the (eventually) revealed risks and about the measures made to decrease them to Group's Managing Board and reports annually similarly to Group's Supervisory Board.

In order to implement the compliance conscious and ethical business operation in all areas of Group:

- Wide range educational program – concentrating on compliance topics and on Ethical Codex – operates in Erste Hungary which are obligatory not only for new co-workers, but every employees regularly need to participate on it.
- The Compliance, Anti-Money Laundering & Fraud Prevention maintains frequent communication with all – so called second line of defense – control areas of Erste Hungary in order to ensure effective organizational and maintenance controls.
- The compliance participates in commenting on internal policies, product developments and remuneration policy. Erste Hungary applies the regulation of the Ethical Codex throughout the process of product development and providing service.
- The Bank operates anonym whistleblowing line signalling ethical and legal violations.

Social banking

Erste Group is committed to ensure equal chances to people and to enterprises to reach a wide range of banking services. In the name of social responsibility Group introduced the Good.Bee program in 2011 which prepared for a new impact level of social banking. The initiative reached significant results during the "Most Innovative Social Investment Award" call. From 2016, Social Banking institutionalized the support ensured by Erste Hungary to those social organizations and groups which need a product or service offer other than the average banking conditions.

Under the aegis of this program, Group in collaboration with Erste Stiftung supports the SEEDS enterprise development program, which takes place with the participation of 67 social enterprises for 1.5 years. In this context Group contributes with free consultancy and with tendering non-refundable financial instruments to develop the socially active enterprises of the future.

The „Erste Higgy Magadban!" tender ended with great success which in 2017 activated nearly 300 tenderer and 90 000 voters in Hungary. Through community voting and jurying, several social enterprises won support for a start from Erste Hungary to reach their goal.

In addition, Group is an active player in the social organizations network via pro bono business development consulting, financing opportunities and creating business cooperations.