Erste Bank Hungary Zrt.

FINANCIAL STATEMENTS
IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING
STANDARDS AS ADOPTED BY THE EUROPEAN UNION
FOR THE YEAR ENDED
31 DECEMBER 2018

Financial Statements 2018 IFRS

I. Income Statement for the year ended 31 December 2018

in HUF million	Notes	2017	2018
Net interest income	1	64,553	66,855
Interest income		69,588	68,337
Other similar income		4,986	10,129
Interest expenses		(6,686)	(7,182)
Other similar expenses		(3,335)	(4,429)
Net fee and commission income	2	41,254	45,892
Fee and commission income		53,243	58,308
Fee and commission expenses		(11,989)	(12,416)
Dividend income	3	2,581	4,337
Net trading result	4	8,418	13,559
Foreign exchange transactions		11,049	(4,537)
Other		(2,631)	18,096
Gains/losses from financial instruments measured at fair value through profit or loss	5	-	(2,208)
Personnel expenses	6	(28,040)	(27,021)
Other administrative expenses	6	(24,661)	(23,880)
Depreciation and amortisation	6	(8,448)	(9,712)
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	7	5,753	x
Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss	8	x	(15)
Net impairment loss on financial assets	9	1,779	x
Impairment result from financial instruments	10	x	7,007
Other operating result	11	(6,403)	(15,764)
Other operating income	11	37,747	7,543
Other operating expense	11	(44,150)	(23,307)
Pre-tax result from continuing operations		**56,786**	**59,050**
Taxes on income	12	(4,343)	(1,551)
Net result for the period		**52,443**	**57,499**

II. Statement of Comprehensive Income for the year ended 31 December 2018

in HUF million	Notes	2017	2018
Net result for the period		**52,443**	**57,499**
Other comprehensive income			
Items that may not be reclassified to profit or loss			
Fair value reserve of equity instruments		x	263
Income tax relating to items that may not be reclassified		-	(24)
Items that may be reclassified to profit or loss			
Available for sale reserve (including currency translation)		3,320	x
Gain/loss during the period		3,320	x
Fair value reserve of debt instruments		x	(3,792)
Gain/loss during the period		x	(3,813)
Reclassification adjustments		x	21
Cash flow hedge reserve		221	-
Gain/loss during the period	page 34	221	-
Deferred taxes relating to items that may be reclassified		(299)	344
Gain/loss during the period		(299)	345
Reclassification adjustments		-	(1)
Total other comprehensive income (loss)		**3,242**	**(3,209)**
Total comprehensive income		**55,685**	**54,290**

Date: Budapest, 4 April 2019

Radován Jelasity
Chairman and CEO

Ivan Vondra
Chief Financial Officer

III. Statement of Financial Position at 31 December 2018

in HUF million	Notes	01.01.2017	31.12.2017	2018
Assets				
Cash and cash balances	13	106,049	21,323	26,845
Financial assets held for trading		116,731	73,068	91,131
Derivatives	14	15,371	21,026	25,930
Other financial assets held for trading	15	101,360	52,042	65,201
Non-trading financial assets at fair value through profit or loss	16	x	x	73,572
Equity instruments		x	x	1,138
Debt securities		x	x	30,702
Loans and advances to customers		x	x	41,732
Financial assets available for sale	17	137,749	129,516	x
Pledged as collateral	41	36,247	15,094	x
Financial assets at fair value through other comprehensive income	18	x	x	137,052
Equity instruments		x	x	1,483
Debt securities		x	x	135,569
Financial assets held to maturity	19	395,338	575,440	x
Pledged as collateral	41	61,659	51,949	x
Loans and receivables to credit institutions	21	145,875	61,242	x
Pledged as collateral	41	1,278	4,085	x
Loans and receivables to customers	22	1,025,762	1,179,531	x
Pledged as collateral	41	92,485	112,194	x
Financial assets at amortised cost	23	x	x	1,966,454
Pledged as collateral	41	x	x	236,210
Debt securities		x	x	657,981
Loans and advances to banks		x	x	95,630
Loans and advances to customers		x	x	1,212,843
Finance lease receivables	26	x	x	37,602
Property and equipment	29	8,657	8,340	8,321
Intangible assets	37	15,666	22,315	21,153
Investments in subsidiaries	52	53,297	54,261	54,567
Current tax assets	30	636	628	1,380
Deferred tax assets	30	-	-	3,321
Assets held for sale	31	-	-	30
Trade and other receivables	27	x	x	14,113
Other assets	32	15,730	18,181	23,222
Total assets		**2,021,490**	**2,143,845**	**2,458,763**

in HUF million	Notes	01.01.2017	31.12.2017	2018
Liabilities and equity				
Financial liabilities held for trading		11,590	15,807	19,839
Derivatives	14	11,590	15,807	19,839
Financial liabilities at amortised cost	33	1,685,431	1,765,614	2,052,164
Deposits from banks		280,012	279,662	391,639
Deposits from customers		1,389,515	1,479,116	1,649,231
Debt securities issued		15,904	6,836	8,471
Other financial liabilities		-	-	2,823
Provisions	34	25,083	8,629	7,270
Deferred tax liabilities	30	238	564	-
Other liabilities	35	28,818	27,216	31,166
Total equity	**36**	**270,330**	**326,015**	**348,324**
Equity attributable to owners of the parent		270,330	326,015	348,324
Subscribed capital		146,000	146,000	146,000
Additional paid-in capital		117,492	117,492	117,492
Retained earnings and other reserves		6,838	62,523	84,832
Total liabilities and equity		**2,021,490**	**2,143,845**	**2,458,763**

Date: Budapest, 4 April 2019

Radován Jelasity
Chairman and CEO

Ivan Vondra
Chief Financial Officer

IV. Statement of Changes in Equity

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

in HUF million	Notes	Subscribed capital	Additional paid-in capital	Retained earnings	Available for sale reserve	Fair value reserve	Deferred tax	Total equity
Total equity at 01 January 2018	36	**146,000**	**117,492**	**56,914**	**6,164**	**-**	**(555)**	**326,015**
Changes of initial application of IFRS 9	E. page 16	-	-	3,773	(6,164)	5,687	43	3,339
Changes of first time IFRS adoption	B.i	-	-	4,680	-	-	-	4,680
Restated as of January 2018		**146,000**	**117,492**	**65,367**	**-**	**5,687**	**(512)**	**334,034**
Dividends				(40,000)				(40,000)
Total comprehensive income		-	-	57,499	-	(3,529)	320	54,290
of which: Net profit / (loss) for the year				57,499				57,499
of which: Other comprehensive income				-		(3,529)	320	(3,209)
Total equity at 31 December 2018	36	**146,000**	**117,492**	**82,866**	**-**	**2,158**	**(192)**	**348,324**

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'	Total equity
Total equity at 01 January 2017		**146,000**	**117,492**	**4,471**	**2,844**	**(221)**	**(256)**	**270,330**
Total comprehensive income		-	-	52,443	3,320	221	(299)	55,685
of which: Net profit / (loss) for the year		-	-	52,443	-	-		52,443
of which: Other comprehensive income		-	-	-	3,320	221	(299)	3,242
Total equity at 31 December 2017	36	**146,000**	**117,492**	**56,914**	**6,164**	**-**	**(555)**	**326,015**

V. Statement of Cash Flows

in HUF million	2017	2018
Net result for the period	**52,443**	**57,499**
Income tax adjustment	4,343	1,551
Income tax adjusted result for the period	**56,786**	**59,050**
Non-cash adjustments for items in net profit/loss for the year		
Depreciation, amortisation and net impairment of non-financial assets	9,726	11,192
Net allocation of credit loss allowances and other provisions	(94,864)	(18,985)
Gains/losses from measurement and derecognition of financial assets and financial liabilities	(6,098)	(32)
Revaluation of subordinated liabilities	(144)	(1,950)
Revaluation of derivatives	(1,218)	90
Other adjustments	(842)	3,357
from which changes of initial application of IFRS 9 (see in Note E, page 16)	-	3,339
from which changes of first time IFRS adoption (see in Note B)	-	4,680
Changes in assets and liabilities from operating activities after adjustment for non-cash components		
Financial assets - held for trading	49,965	(14,113)
Non-trading financial assets at fair value through profit or loss		
Equity instruments	x	(1,138)
Debt securities	x	(30,702)
Loans and advances to customers	x	(41,732)
Financial assets - available for sale	2,719	x
Financial assets at fair value through other comprehensive income		
Equity instruments	x	239
Debt securities	x	(2,929)
Financial assets - held to maturity	(1,702)	x
Loans and receivables to credit institutions	84,633	x
Loans and receivables to customers	(76,847)	x
Financial assets at amortised costs		
Debt securities	x	661
Loans and advances to banks	x	(34,388)
Loans and advances to customers	x	(15,729)
Finance lease receivables	x	(37,903)
Other assets from operating activities	4,106	(19,073)
Financial liabilities - held for trading	(867)	(8)
Financial liabilities measured at amortised cost	80,327	288,500
Deposits from banks	(206)	113,927
Deposits from customers	89,601	170,115
Debt securities issued	(9,068)	1,635
Other financial liabilities	-	2,823
Other liabilities from operating activities	(1,602)	3,950
Payments for taxes on income	(2,945)	(5,886)
Cash flow from operating activities	**101,133**	**142,472**

Proceeds of disposal		
Financial assets - held to maturity	35,466	x
Financial assets - available for sale	65,159	x
Financial assets at fair value through other comprehensive income - Equity investments	x	142
Financial assets at fair value through other comprehensive income - Debt instruments	x	44,972
Financial assets at amortised costs - Debt securities	x	93,783
Property and equipment, intangible assets and investment properties	351	71
Investments in subsidiaries	-	8,130
Acquisition of		
Financial assets - held to maturity	(213,867)	x
Financial assets - available for sale	(50,871)	x
Financial assets at fair value through other comprehensive income - Equity investments	x	(294)
Financial assets at fair value through other comprehensive income - Debt instruments	x	(53,175)
Financial assets at amortised costs - Debt securities	x	(176,674)
Property and equipment, intangible assets and investment properties	(20,098)	(9,905)
Investments in subsidiaries	(2,000)	(4,000)
Cash flow from investing activities	**(185,859)**	**(96,950)**
Capital increases	-	-
Dividends paid to equity holders of the parent	-	(40,000)
Cash flow from financing activities	**-**	**(40,000)**
Cash and cash equivalents at beginning of period	**106,049**	**21,323**
Cash flow from operating activities	101,133	142,472
Cash flow from investing activities	(185,859)	(96,950)
Cash flow from financing activities	-	(40,000)
Cash and cash equivalents at end of period	**21,323**	**26,845**

Cash flows related to interest and dividends (included in cash flow from operating activities)		
Interest received	78,976	76,330
Dividends received	2,581	4,337
Interest paid	(8,184)	(9,673)

VI. Notes to the Financial Statements

A. GENERAL INFORMATION

Erste Bank Hungary Zrt. *(referred to as 'Bank'or 'Erste 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 Bank. 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.

The annual financial statement, that is prepared as separate financial statement for local purposes, is published and available on the following website:
https://www.erstebank.hu/hu
The Bank prepares its consolidated financial statement under IFRS that is published and available on the following website:
https://www.erstebank.hu/hu

The financial statements are prepared in English and Hungarian. In case of divergence between the language versions, the English version shall prevail.

As of 31 December 2018, 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 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 2018, DIE ERSTE Österreichische 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.

.

Erste Bank'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 Bank concentrates its activity in the Hungarian market.

Erste Banks's financial statements are legally required to be audited in order to ensure independent control and review of the accounts.

B. FIRST TIME ADOPTION

These financial statements, for the year ended 31 December 2018, are the first Erste Bank has prepared in accordance with International Financial Reporting Standards (IFRS). For periods up to and including the year ended 31 December 2017, Erste Bank prepared its financial statements in accordance with Hungarian generally accepted accounting practice (local GAAP).

Accordingly, Erste Bank has prepared financial statements which comply with IFRS applicable for periods ending on or after 31 December 2018, together with comparative period data as at and for the year ended 31 December 2017, as described in the accounting policies. In preparing these financial statements, Erste Bank's opening statement of financial position was prepared as at 1 January 2017, Erste Bank's date of transition to IFRS. This note explains the principal adjustments made by Erste Bank in restating its local GAAP statement of financial position as at 1 January 2017 and its previously published local GAAP financial statements as at and for the year ended 31 December 2017 to IFRS.

Estimates

Estimates at 1 January 2017 and at 31 December 2017 are consistent with those made for the same dates in accordance with IFRS in the consolidated financial statements, except of those arising from application of IFRS9 relative to those estimates required by IFRS to remeasure and adjust retrospectively.

Exemptions applied

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

According to IFRS1 D17 if a parent becomes a first time adopter for its separate financial statements later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

According to IFRS1 D15 the Bank measures investments in its subsidiaries at deemed cost equal to carrying amount according to previous GAAP, as under IFRS the Bank opted to measure investments in its subsidiaries at cost in accordance with IAS27, presented in line item 'Investments in subsidiaries'.

Reconciliation of equity as at 1 January 2017 (date of transition to IFRS)

in HUF million	Comments	31 December 2017	01 January 2017
Total equity under HAS		**360,592**	**279,246**
Impairment and provisions	a,	(18,619)	(7,690)
Valuation of securities at AC or FVPL	b,	(14,091)	(2,096)
Valuation of securities at FVOCI	b, c,	454	315
Valuation of investments	d,	(285)	(228)
Amortised cost method effect on loans and receivables	e,	(34)	1,700
Deferred taxes	f,	(615)	(238)
Other adjustments	g,	(1,387)	(681)
Total equity under IFRS		**326,015**	**270,328**
Changes of first time IFRS adoption	i,	4,680	-
Total equity under IFRS with first time adoption adjustments		**330,695**	**270,328**

Reconciliation of assets and liabilities as at 1 January 2017 (date of transition to IFRS)

in HUF million	Comments	31 December 2017	01 January 2017
Total assets under HAS		**2,179,025**	**2,038,492**
Impairment	a	(19,775)	(8,249)
Valuation of securities at AC or FVPL	b	(12,465)	(2,095)
Initial FV correction of loans and receivables at AC	h	1,921	2,760
Valuation of securities at FVOCI	b, c	454	315
Valuation of investments	d	(285)	(228)
Amortised cost method effect on loans and receivables	e	(34)	1,700
Other adjustments	g	(4,996)	(11,207)
Total assets under IFRS		**2,143,845**	**2,021,490**

in HUF million	Comments	31 December 2017	01 January 2017
Total liabilities under HAS		**1,818,433**	**1,759,246**
Provisions	a	2,981	(558)
Valuation of securities at AC or FVPL	b	1,626	2
Initial FV correction of deposits at AC	h	1,921	2,760
Deferred tax	f	615	238
Other adjustments	g	(7,746)	(10,526)
Total liabilities under IFRS		**1,817,830**	**1,751,162**

Reconciliation of income for the year ended 31 December 2017

in HUF million	Comments	31 December 2017
Total net profit of the year under HAS		**80,974**
Impairment and provision	a	(11,281)
Valuation of securities at AC or FVPL	b	(13,389)
Initial FV correction of loans and receivables at AC	h	101
Valuation of securities at FVOCI subject of repurchase agreement	b	(1,833)
Amortised cost method effect on loans and receivables	e	(2,632)
Other adjustment	g	503
Total net profit of the year under IFRS		**52,443**
Other comprehensive income		3,242
Total comprehensive income under IFRS		**55,685**

Reconciliation of cash and cash equivalents

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

in HUF million	31 December 2017	01 January 2017
Cash in hand	19,792	16,470
Nostro account with Hungarian National Bank	500	7,650
Cash and cash equivalents by local GAAP	**20,292**	**24,120**
In addition in IFRS accounts:		
Interbank account with Hungarian National Bank	1,031	81,929
Cash and cash equivalents by IFRS	**21,323**	**106,049**

.

Notes to the reconciliation of equity as at 1 January 2017 and 31 December 2017 and income and other comprehensive income for the year ended 31 December 2017

a) Impairment allocation according to IFRS reduces the book value of loans and debt securities and increases the provision for credit lines and guarantees compared to HAS data.
   There are two major differences between local GAAP and IFRS in relation to the valuation of risk impairment/provisions:
   1. Local GAAP does not allow to recognise IBNR (‘incurred but not reported’) provision.
   2. Risk exposure is different: under IFRS, impairment is calculated on the amortised cost basis, while under local GAAP it is based on outstanding capital. The difference in discounted cash flows of an impaired loan between two valuation dates is unwinding and is recognised in net interest income under IFRS.

b) Two main difference are included in this adjustment:
   1. Delivery repo transactions are recognised as sales transactions under local GAAP. Under IFRS the asset in a repo deal is recognised in the books of the transferor, as derecognition criteria are not met. In this sense not only currently open repurchased or reverse repurchase transactions of this nature influence balance sheet, but given the fact that first-in-first-out method is applied, a cumulative effect is presented in the adjustments.
   2. Premium and discount is amortised using the effective interest rate method under IFRS, while in HAS linear amortisation is applied.

c) Securities valued at FVOCI, classified as Available for sale under IAS39, beside might be subject to repurchase or reverse repurchase agreement linked FV adjustment (see comment b)), are subject of premium/discount recognition under local GAAP in a way, that it is part of the fair value, while recognised in profit and loss over the maturity in IFRS.

d) Based on local standards impairment allocation was historical approach driven, while under IFRS future performance potential was taken into consideration as well.

e) There are two major differences between local GAAP and IFRS:
   1. Amortisation of upfront fees part of the effective interest rate method under IAS39 - upfront fees are amortised using the effective interest rate over the maturity of the underlying instrument and shown in exposure under IFRS. For local GAAP upfront fees are recognised immediately in the income statement.
   2. Suspended interest - interest is suspended when the due amount is not received till balance sheet preparation date under local GAAP rules while interest is recognised under IFRS on all loans even on non-performing loans for the first 90 days that amounts are overdue. The source of interest income on impaired loans and receivables is unwinding under IFRS.

f) Local GAAP does not allow recognition of deferred taxes.

g) Beside diverse accrual items like unused holidays, the main part presented in assets and liabilities is coming from netting rules differing under the two accounting standards. Netting rule difference is reflected in ‘Other assets’ and ‘Other liabilities’ balance sheet items.

h) In 2013 National Bank of Hungary introduced a program in order to intensify SME lending (funding for lending program). Participant credit institutions receives funding at zero percent, while provide lending to SME sector with a certain margin cap (‘funding + defined’ margin formula). Initial FV adjustment representing the off market characteristic of the construction decreasing the net carrying amount of relevant loans and deposit.
   The initial fair value difference is amortised over the life time of the loan through the net interest income.

   On a smaller scale, initial fair valuation of certain municipality loans taken over by the government also contributes to initial fair value adjustment.

i) Two subsidiaries owned 100% by the Bank (Erste Lakástakarékpénztáér Zrt. Erste Jelzálogbank Zrt.) were also subject to compulsory IFRS transition in the same date as the Bank. The two subsidiaries applied IFRS 1 E1 and E2 in compulsory transition to IFRS, so their comparative data relating to financial instruments were presented under the previous GAAP.
Transitional difference between their equity under local GAAP and IFRS indicated a need to review impairment and lead to release of 4,680 million forint. Pre-transition valuation of investments were in line with local GAAP and regulatory requirements, so for that reason arising difference is recognised in the opening equity at 01 January 2018.

C. ACQUISITIONS, MERGERS AND DISPOSALS

The Bank signed a preliminary contract at the end of 2018 on selling the company Erste Lakáslízing Zrt. The contract covers all the material conditions of the sale. On that base the company is reclassified into 'Assets held for sale' as a disposal group of assets, under IFRS5. The value of 'Asset held for sale' is 30 million forint as of 31 December 2018, representing the net book value of the investment. The sale is expected to be realised in the first half year of 2019.

D. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS

In October 2018 a legal act was accepted by the Parliament (2018:LXIII) modifying the legal act regulating building societies (1996:CXIII), enacted 17 October 2018.
After enacting the new regulation, clients contracting with building societies housing purpose saving products are not entitled to government subsidy. The government subsidy amounts up to 30% of the savings, maximised in 72 thousand forint per year, per contract and contracts signed before 17 October 2018 stayed under the subsidised scheme.
The Bank directly owns a building society (Erste Lakástakarékpénztár Zrt.).

E. ACCOUNTING POLICIES

a) BASIS OF PREPARATION

The financial statements of Erste Bank for the 2018 financial year and the comparable data for 2017 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 Bank prepares consolidated annual financial statements according to the same accounting framework as the separate annual financial statements. The Bank's separate and consolidated annual financial statements are approved and published on the same day.

In accordance with the applicable measurement models prescribed or permitted under IFRS, the financial statements have been prepared on a cost (or amortised cost) basis, except for financial assets measured at fair value through other comprehensive income, financial assets and liabilities measured at fair value through profit or loss and financial instruments.

Accounting policies are consistent with those applied in 2017 except for the implementation of IFRS 9 and IFRS 15.

The financial statements have been prepared on a going concern basis.

Except as otherwise indicated, all amounts are stated in millions of Hungarian forint (HUF). The tables in this report may contain rounding differences.

The financial statements for the year ended 31 December 2018 were authorised for issue in accordance with a resolution of the directors on 4 April 2019.

ACCOUNTING AND MEASUREMENT METHODS

Foreign currency translation

The 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.

IFRS 9 Financial Instruments

As of 1 January 2018, Erste Bank has adopted IFRS 9 'Financial Instruments' as issued by the IASB in July 2014 and endorsed by the EU in 2016. This resulted in changes in accounting policies for classification and measurement of financial assets and financial liabilities, as well as for impairment of financial assets. IFRS 9 also significantly amends IFRS 7 'Financial Instruments: Disclosures' due to which disclosures of information on financial instruments have been adapted to the new requirements.

As permitted by the transitional provisions of IFRS 9, Erste Bank elected not to restate comparative amounts for the previous financial year 2017. As a result, the comparative period columns in the 2018 financial statements reflect the structure used in 2017 financial statements. Also, the comparative period disclosures in the notes are based on the original classification and measurement requirements of IAS 39 (as superseded by IFRS 9) and IFRS 7 (before the consequential amendments resulting from IFRS 9). Due to this fact, accounting policies relevant for financial instruments in accordance with IAS 39 are also disclosed.

The financial impact of IFRS 9 adoption is detailed below.

i. Classification and measurement of financial instruments

The table below presents changes between measurement categories and carrying amounts of financial assets and financial liabilities under IAS 39 and IFRS 9 as at 1 January 2018. To illustrate the transition impact, the effects are disclosed in respect of original balance sheet positions reflecting IAS 39 requirements.

in HUF million	Comments	Original classification under IAS 39		New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
		Portfolio	Measurement method			
Financial assets						
Cash and cash balances		Loans and receivables	AC	Amortised cost	21,323	21,322
Derivatives		Held-for-trading	FVPL	Held-for-trading (FVPL)	21,026	21,026
Other trading assets		Held-for-trading	FVPL	Held-for-trading (FVPL)	52,042	52,042
Loans and receivables to credit institutions	a	Loans and receivables	AC	Amortised cost	61,242	61,215
				Designated at FVPL	-	-
Loans and receivables to customers	b	Loans and receivables	AC	Amortised cost	1,088,712	1,090,283
				Mandatorily at FVPL	47,454	48,674
		Loans and receivables	Finance Lease and trade receivables	Finance Lease and trade receivables	43,365	43,148
Financial assets - available for sale (Debt securities)		AFS	FVOCI	Amortised cost	-	-
				Mandatorily at FVPL	-	-
				FVOCI	127,357	127,357
Financial assets - available for sale (Equity instruments)		AFS	FVOCI	FVPL	970	970
				FVOCI	1,189	1,189
Financial assets - held to maturity	c	Held-to-maturity	AC	Amortised cost	575,440	575,334
				Mandatorily at FVPL	-	-
				Designated at FVPL	-	-
				FVOCI	-	-
Total financial assets					**2,040,120**	**2,042,559**
Financial liabilities						
Derivatives		Held-for-trading	FVPL	Held-for-trading (FVPL)	(15,807)	(15,807)
Financial liabilities measured at amortised cost		Amortised cost	AC	Amortised cost	(1,765,614)	(1,765,614)
				Designated at FVPL	-	-
Total financial liabilities					**(1,781,421)**	**(1,781,421)**

(a) ‚Loans and receivables to credit institutions‘ staying under amortised cost were subject to impairment calculation under IFRS9 rules leading to immaterial amount (15 million forint) of impairment release as effect of transition.

(b) A part of ‚Loans and receivables to customers‘ were classified into ‚Mandatorily at FVPL‘ valuation category, as their contractual cash flow characteristics contain a leverage, IFRS9 column value representing their fair value. See in ‚SPPI assessment‘ chapter, page 41.
Items remaining under amortised cost valuation were subject to impairment calculation under IFRS9 rules leading in case of loans to release of impairment of 1.745 billion forint, in case of leasing items to additional impairment allocation of 216 million forint.

(c) A smaller part of security portfolio kept earlier in held to maturity category valued at amortised cost were classified by decision into fair value through other comprehensive income valuation category modifying their carrying amount from amortised cost to fair value.

ii. Reconciliation of carrying amounts of financial assets based on measurement categories

in HUF million	Comments	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurement	IFRS 9 carrying amount 01 January 2018	Retained earnings effects
Amortised cost	a	**1,805,313**	**-**	**-**	**1,805,313**	**-**
Additions:						
from IAS 39 AC (L&R, HTM) (impairment remeasurement)	b	-	-	1,384	1,384	(1,384)
Subtractions:						
to IFRS 9 Mandatorily at FVPL (IAS 39: L&R) – loans and advances to customers	c	-	(47,454)	-	(47,454)	-
Total change		**-**	**(47,454)**	**1,384**	**(46,070)**	**(1,384)**
Total - amortised cost	d	**1,805,313**	**(47,454)**	**1,384**	**1,759,242**	**(1,384)**
Fair value through other comprehensive income		**129,516**	**-**	**-**	**129,516**	**-**
Fair value through other comprehensive income – debt securities		**127,357**	**-**	**-**	**127,357**	**-**
Subtotal change – debt securities at FVOCI		**-**	**-**	**-**	**-**	**-**
Subtotal – debt securities at FVOCI		**127,357**			**127,357**	
Fair value through other comprehensive income – equity instruments		**2,159**	**-**	**-**	**2,159**	**-**
Subtractions:						
to IFRS 9 FVPL (IAS 39: AFS)	e	-	(970)	-	(970)	-
Subtotal change – equity instruments at FVOCI		**-**	**(970)**	**-**	**(970)**	**-**
Subtotal – equity instruments at FVOCI		**2,159**	**(970)**	**-**	**1,189**	**-**
Total change		**-**	**(970)**	**-**	**(970)**	**-**
Total – fair value through other comprehensive income		**129,516**	**(970)**	**-**	**128,546**	**-**
Fair value through profit or loss		**73,068**	**-**	**-**	**73,068**	**-**
Additions:						
from IAS 39 AC (L&R) (IFRS 9: Mandatorily at FVPL) – loans and advances to customers	d	-	47,454	1,220	48,674	(1,220)
from IAS 39 AC (HTM) (IFRS 9: Designated at FVPL) – debt securities		-	-	-	-	-
from IAS 39 AC (HTM) (IFRS 9: Mandatorily at FVPL) – debt securities		-	-	-	-	-
from IAS 39 FVOCI (AFS) (IFRS 9: Mandatorily at FVPL) – debt securities		-	-	-	-	-
from IAS 39 FVOCI (AFS) – equity instruments	e	-	970	-	970	
from hedge accounting derivatives						
Subtractions:						
to IFRS 9 AC (IAS 39: FVO) – debt securities						
to IFRS 9 FVOCI (IAS 39: FVO) – debt securities						
Total change to Fair value through Profit or Loss		**-**	**48,424**	**1,220**	**49,644**	**(1,220)**
Total – fair value through profit or loss	f	**73,068**	**48,424**	**1,220**	**122,711**	**(1,220)**
Total – financial assets		**2,007,896**	**-**	**2,604**	**2,010,500**	**(2,604)**

.

Note: Remeasurement includes effects of both revaluation and impairment changes.
(a) The amount includes IAS 39 balance sheet line items with following carrying amounts in million forint:

- cash and cash balances: 21,323;
- loans and receivables to credit institutions: 61,242;
- loans and receivables to customers: 1,147,308 (excluding finance lease receivables but including trade receivables); and
- financial assets – held to maturity: 575,440.

(b) Transition to IFRS9 resulted an impairment release as consequence of the portfolio quality improvement of the loan portfolio and the low level of loans with significant increase of credit risk (stage2).

(c) The reclassification relates to loans to customers that do not have contractual cash flows that are solely payments of principal and interest (SPPI) and thus have to be measured at FVPL. The most significant cases are loans having interest mismatch features that do not pass the quantitative testing required by IFRS 9 and loans having a leverage element in the contractual interest rate.

(d) The IFRS 9 carrying amount as at 1 January 2018 includes IFRS 9 balance sheet line items with following carrying amounts in million forint:

- cash and cash balances 21,323;
- financial assets at amortised cost:
    - debt securities 578,542
    - loans and advance to banks: 61,215;
    - loans and advances to customers: 1,087,074 and
    - trade receivables: 11,089.

(e) The reclassification from the available for sale category under IAS 39 to the fair value through profit or loss category under IFRS 9 relates to those investments in equity instruments that are not held for trading and that were not designated as measured at FVOCI upon the transition to IFRS 9.

(f) The amount includes IAS 39 balance sheet line items with following carrying amounts in million forint:

- financial assets held for trading 73,067

This amount were included in the financial liabilities designated at fair value through profit or loss as of 1 January 2018 under IFRS 9:

- derivatives: 21,026 and
- other financial assets held for trading: 52,042.

iii. Reconciliation of carrying amounts of financial liabilities based on measurement categories

in HUF million	Comments	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurement	IFRS 9 carrying amount 1 January 2018	Retained earnings effects	OCI effects
Amortised cost	a	**(1,765,614)**	**-**	**-**	**(1,765,614)**	**-**	**-**
Subtractions:		-	-	-	-	-	-
to IFRS 9 FVO (IAS 39: AC)		-	-	-	-	-	-
Total change		**-**	**-**	**-**	**-**	**-**	**-**
Total – amortised cost		**(1,765,614)**	**-**	**-**	**(1,765,614)**	**-**	**-**
Fair value through profit or loss	b	**(15,807)**	**-**	**-**	**(15,807)**	**-**	**-**
Additions:		-	-	-	-	-	-
from IAS 39 AC		-	-	-	-	-	-
Total change		**-**	**-**	**-**	**-**	**-**	**-**
Total – fair value through profit or loss		**(15,807)**	**-**	**-**	**(15,807)**	**-**	**-**
Total – financial liabilities		**(1,781,421)**	**-**	**-**	**(1,781,421)**	**-**	**-**

(a) The amount includes IAS 39 balance sheet line items with following carrying amounts in million forint (including amounts transferred from other line items which are explained below):

- deposits from banks: 279,662;
- deposits from customers: 1,479,116
- debt securities issued: 6,836

(b) The amount includes IAS 39 balance sheet line items with following carrying amounts in million forint:

- derivatives – held for trading: 15,807

iv. Reconciliation of impairment allowances

The following table reconciles the amounts of loss allowances as at 31 December 2017 based on the IAS 39 incurred loss impairment model with the amounts as at 1 January 2018 subject to the IFRS 9 expected credit loss impairment model:

in HUF million	IAS 39/IAS 37 31 December 2017	Reclassifications	Remeasurement	IFRS 9 01 January 2018
Debt instruments at AC	(56,832)	1,837	3,307	(51,687)
Debt instruments at FVOCI	-	(19)	-	(19)
Finance lease	(663)	-	(152)	(815)
Off balance-sheet exposures (loan commitments and guarantees given)	(3,560)	-	1169	(2,391)
Total	**(61,055)**	**1,818**	**4,324**	**(54,912)**

.

The column Reclassifications relates to changes in impairment allowances due to differences in the scope of requirements between IFRS 9 and IAS 39. As a result, the decrease in impairment due to reclassifications amounting to 1,818 million forint:

- relates mainly to reversals of IAS 39-based loan loss provisions recognised under IAS 39 in respect of debt instruments at amortised cost that were classified as mandatorily at FVPL under IFRS 9;
- is also affected by increase in loss allowances newly recognised on 1 January 2018 of 19 million HUF in respect of former AFS debt securities classified at FVOCI under IFRS 9.

The column Remeasurement, having an impact on the equity, relates to changes in impairment allowances that were (under IAS 39 for financial assets and under IAS 37 for off-balance sheet credit risk bearing exposures) and continue to stay (under IFRS 9) in the impairment calculation scope. In this respect:

- the line 'Debt instruments at AC' mainly contributing to the transitional difference, captures differences in loss allowances for debt instruments measured at amortised cost under IFRS 9 that were previously classified as loans and receivables (other than trade and other receivables) and held-to-maturity in accordance with IAS 39.

Transition to IFRS9 resulted an impairment release as consequence of the portfolio quality improvement of the loan portfolio and the low level of loans with significant increase of credit risk (stage2).
The defaults rate of the loan portfolio is decreasing continuously reaching a record low level in both corporate and retail segment and further improvement is expected due to the strict lending criteria.
Improved portfolio quality also means, that the existing loan portfolio bears no significant increase of credit risk.

Overall, the re-classifications and impairment remeasurements effects increased the Bank equity by 5,830 million forint. This amount combines an increase in equity from remeasurements of 4,147 million forint and an increase in equity of 1,818 million from reclassifications of debt instruments.

v. Deferred tax effects upon transition to IFRS 9
The following table presents the changes in the carrying amounts of Erste Bank's deferred tax assets and liabilities due to the initial application of IFRS 9:

in HUF million	IAS 39 Closing balance 31 December 2017	IFRS 9 Opening balance 01 January 2017	Retained earnings effects	OCI effects
Deferred tax liabilities	(564)	(521)	-	43

These changes result primarily from the impact of IFRS 9 initial application adjustments over the underlying temporary differences between the accounting and tax values of the financial assets and liabilities. To a much lesser extent, they also result from fiscal profit forecasts updates due to the influence of IFRS 9 over the amount or timing of reversal of the reassessed temporary differences as of the transition date.

vi. De-designation from and designations to fair value option upon transition to IFRS 9

No financial assets and financial liabilities were de-designated from being measured at FVPL upon transition to IFRS 9.

Financial instruments

A financial instrument is any contract giving rise to a financial asset of one party and a financial liability or equity instrument of another party. In accordance with IFRS 9 (as well as IAS 39), all financial assets and liabilities – which also include derivative financial instruments – have to be recognised on the balance sheet and measured in accordance with their assigned categories.

Measurement methods for financial instruments

Measurement of financial assets and financial liabilities is subject to two primary measurement methods.

i. Amortised cost and effective interest rate
Amortised cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount. For financial assets the amount is adjusted for any loss allowance.

The effective interest rate ('EIR') is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of the financial asset (i.e. its amortised cost before adjusting for any loss allowance) or to the amortised cost of the financial liability. The estimated cash flows consider all the contractual terms of the financial instrument but disregard the expected credit losses. The calculation includes transaction costs, origination fees that are an integral part of the EIR and all other premiums and discounts to the par amount.
For purchased or originated credit-impaired financial assets ('POCI', see part 'Impairment of financial instruments under IFRS 9'), credit-adjusted EIR is used. It is the rate that exactly discounts the estimated future cash flows which consider expected credit losses to the amortised cost of a financial asset.

The EIR is used for recognition of interest income and interest expense. Interest income is calculated in the following way:
EIR applied to the gross carrying amount for financial assets that are not credit-impaired (Stage 1 and Stage 2, see part 'Impairment of financial instruments');

- EIR applied to the amortised cost for financial assets that are credit-impaired (Stage 3, see 'Impairment of financial instruments');
- and credit-adjusted EIR applied to the amortised cost for POCI financial assets.

Under IAS 39, the EIR is applied to the gross carrying amount of the financial assets and, for financial assets that are individually impaired, to the amortised cost.

Interest expense is calculated by applying the effective interest rate to the amortised cost of a financial liability.

ii. Fair value
Fair value is the price that would be received if an asset were sold or paid if a liability were transferred in an orderly transaction between market participants on the measurement date. The definition also applies to fair value measurements of non-financial assets and liabilities. Details on valuation techniques applied for fair value measurement and on the fair value hierarchy are disclosed in Note 45 Fair value of financial instruments.

Initial recognition and measurement

i. Initial recognition
Financial instruments are initially recognised when Erste Bank becomes a party to the contractual provisions of the instrument. Regular way (spot) purchases and sales of financial assets are recognised at the settlement date, which is the date that an asset is delivered.

ii. Initial measurement
Financial instruments are measured initially at their fair value including transaction costs (except for financial instruments at fair value through profit or loss, for which transaction costs are recognised directly in profit or loss). In most cases, the fair value at initial recognition equals the transaction price, i.e. the price transferred to originate or acquire a financial asset or the price received to issue or incur a financial liability.

Classification and subsequent measurement of financial assets under IFRS 9

In accordance with IFRS 9, the classification and subsequent measurement of financial assets depend on the following two criteria:
(i) The business model for managing the financial assets – the assessment is focused on whether the financial asset is part of a portfolio in which the assets are held in order to collect contractual cash flows, to both collect the contractual cash flows and sell the assets or they are held in other business models.
(ii) The cash flow characteristics of the financial assets – the assessment is focused on whether 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.
Application of these criteria leads to classification of financial assets into three measurement categories.

i. Financial assets at amortised cost
Financial assets are measured at amortised cost if they are held in a business model whose objective is to collect contractual cash flows, and their contractual cash flows are SPPI.

On the balance sheet, these assets are carried at amortised cost, i.e. the gross carrying amount net of the credit loss allowance. They are presented under the line 'Financial assets at amortised cost', 'Trade and other receivables' and 'Cash and cash balances'. Cash balances include only claims (deposits) against central banks and credit institutions that are repayable on demand. Repayable on demand means that they may be withdrawn at any time or with a term of notice of only one business day or 24 hours. Mandatory minimum reserves are also shown under this item.

Finance lease receivables were decided to be separated as a balance sheet line item in 2018. The separation was not applied retrospectively, the balance of finance lease receivables is presented as part of 'Loans and receivables to customers' in 2017.

Interest income on these assets is calculated by effective interest method and is included under the line 'Interest income' under 'Net interest income' in the statement of income. Impairment gains or losses are included in the line 'Impairment result from financial instruments'. Gains and losses from derecognition (such as sales) of the assets are reported under the line item 'Gains/losses from derecognition of financial assets measured at amortised cost'.

At Erste Bank, financial assets at amortised cost constitute the largest measurement category, which includes the vast majority of loan business to customers (except for certain loans measured at fair value through profit or loss), interbank lending business (including reverse repo transactions), deposits with central banks, amounts in the course of settlement, trade and other receivables. Investments in debt securities measured at amortised cost may be acquired with different business objectives (such as fulfilling internal/external liquidity risk requirements and efficient placement of the structural liquidity surplus, strategic positions decided by the board of directors, initiation and fostering of client relationships, substitution of loan business or other yield enhancement activities). Their common attribute is that significant and frequent sales of such securities are not expected. For a description of what sales are considered as compliant with the held to collect contractual cash flows business model, see the 'Business model assessment' part in chapter d) Significant accounting judgements, assumptions and estimates'.

ii. Financial assets at fair value through other comprehensive income
Debt instrument financial assets are measured at fair value through other comprehensive income (FVOCI) if their contractual cash flows are SPPI-compliant and they are held within a business model whose objective is achieved by both to collect contractual cash flows and sell the assets. On the balance sheet, they are included as 'Debt securities' under the line 'Financial asset at fair value through other comprehensive income'.

Interest income on these assets is calculated using the effective interest method and is included in the line 'Interest income' under 'Net interest income' in the statement of income. Impairment gains and losses are recognised in profit or loss in the line 'Impairment result from financial instruments' with opposite entry in OCI rather than against the asset value. As a result, the measurement impact recognised in profit or loss is the same as for financial assets measured at amortised cost.

The difference between the fair value at which the assets are carried in the balance sheet and the amortised cost component is recognised as accumulated OCI in equity specifically under 'Fair value reserve' in the statement of changes in equity. The change for the period is reported as OCI in the statement of comprehensive income in the line 'Fair value reserve of debt instruments'. When the financial asset is derecognised, the amount previously accumulated in OCI is reclassified to profit or loss and reported under the line 'Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss'.

Erste Bank classifies investments in debt securities as measured at FVOCI. They are part of 'held to collect and sell' business models. Similarly to debt instruments, assets measured at amortised cost, they relate to various business objectives such as fulfilling internal/external liquidity risk requirements and efficient placement of the structural liquidity surplus, strategic positions decided by the board of directors, initiation and fostering of client relationships, substitution of loan business or other yield-enhancement activities. The common attribute for investments in debt instruments at FVOCI is that an active yield optimisation via sales is integral to achieving the objectives. The sales are carried out in order to optimise the liquidity position or to realise the fair value gains or losses. As a result, the business objectives are achieved through both collecting contractual cash flows and sales of the securities.

For certain investments in equity instruments that are not held for trading, Erste Bank makes use of the option to measure them at FVOCI. This election is applied to strategic, significant banking business relationship investments (except for insurance business). The fair value gains or losses for the period are reported as OCI in the line 'Fair value reserve of equity instruments' of the statement of comprehensive income. The cumulative gains or losses are included under 'Fair value reserve' in the statement of changes in equity. The amount recognised in OCI is never reclassified to profit or loss. However, upon derecognition of the investments in equity instruments at FVOCI the amount accumulated in OCI is transferred to retained earnings. Dividends received on these investments are reported under the line 'Dividend income' of the statement of income. On the balance sheet, financial assets measured at fair value through OCI are included as 'Equity instruments' under the line 'Financial asset at fair value through other comprehensive income'.

iii. Financial assets at fair value through profit or loss

There are various reasons for assigning the fair value through profit or loss (FVPL) measurement category to financial assets:

Financial assets whose contractual cash flows are not considered as SPPI are automatically measured at FVPL. In the business of Erste Bank, this concerns certain loans to customers and debt securities. The main reason for the loans failing the SPPI assessment is that they have interest mismatch features that do not pass the quantitative testing required by IFRS 9 (see description in the part 'SPPI assessment' of chapter d) Significant accounting judgements, assumptions and estimates').

Other source of FVPL measurement relates to financial assets that are part of residual business models, i.e. they are neither held to collect contractual cash flows nor held to either collect contractual cash flows or sell the assets. These financial assets are generally expected to be sold before their maturity or they are managed and their performance is evaluated on a fair value basis. In the business of Erste Bank, such business models are typical of assets that are held for trading (i.e. financial assets held by the trading function of the bank), of assets whose value is expected to be primarily realised through sales.

Erste Bank also makes use of the option to designate some financial assets as measured at FVPL at initial recognition. Such a classification is used if it eliminates or significantly reduces an accounting mismatch between the financial asset, which in the absence of such a classification would be measured at amortised cost or at FVOCI, and the related derivative measured at FVPL.

On the balance sheet, debt instrument financial assets and derivatives measured at FVPL are presented in line item 'Financial assets held for trading', sub-items 'Other financial assets held for trading' and ‚Derivatives'. 'Non-trading financial assets at fair value through profit or loss' contains loans to customers valued at fair value through profit or loss either because their contractual cash flows are not SPPI or they are held as part of residual business models that are other than held for trading.

Investments in equity instruments that are held for trading (i.e. financial assets held by the trading function of the bank) are measured at FVPL. They are included in the balance sheet under the line 'Financial assets held for trading', sub-item 'Other financial assets held for trading'. Investments in equity instruments that are not held for trading are also measured at FVPL (unless they are designated at FVOCI). They are presented in the balance sheet under 'Non-trading financial assets at fair value through profit or loss', sub-item 'Equity instruments', sub-category 'mandatorily at fair value through profit or loss' in Note 16.

In the statement of income, the profit or loss effects of financial assets measured at FVPL are split into interest income or dividend income and fair value gains and losses. In sub-item 'Other similar income', line item 'Net interest income' interest income on financial assets at FVPL are present-ed. This category also includes negative interest rate related interest income on financial liabilities. The dividend income on equity instruments is presented in the line 'Dividend income'. The fair value gains or losses are calculated net of the interest or dividend income, and they also include transaction costs and origination fees. They are reported in the line 'Net trading result' for financial assets held for trading and in the line 'Gains/losses from financial instruments measured at fair value through profit or loss' in case of non-trading financial assets at FVPL. For investments in funds, which are not by Erste Bank, the interest or dividend component is not separated from the fair value gains or losses.
'Other similar income' is separated on voluntary basis from 2018 and applied retrospectively in the financial statements of 2018.

Classification and subsequent measurement of financial liabilities under IFRS 9

Financial liabilities are classified as measured at amortised cost unless they are measured at fair value through profit or loss.

i. Financial liabilities at amortised cost

For presentation on the balance sheet, the line item ‘Financial liabilities measured at amortised cost’ is used. The liabilities are further broken down into ‘Deposits from banks’, ‘Deposits from customers’, ‘Debt securities issued’ and ‘Other financial liabilities’.

Interest expenses incurred are reported in the line item ‘Interest expenses’ under ‘Net interest income’ in the statement of income. Gains and losses from derecognition (mainly repurchase) are reported under the line item ‘Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss’.

ii. Financial liabilities at fair value through profit or loss

Financial liabilities at FVPL consist of financial liabilities held for trading and financial liabilities designated at FVPL.

Non-derivative financial liabilities held for trading are those which are incurred principally for the purpose of repurchasing them in the near term. In the business of Erste Bank non-derivative held for trading liabilities are largely comprise short sales. These arise from obligations to return securities, which are purchased under agreements to resell or are borrowed through securities lending transactions and subsequently sold to third parties. On the balance sheet such liabilities are presented under the line ‘Financial liabilities held for trading’, sub-item ‘Other financial liabilities’. The gains or losses on financial liabilities held for trading are reported in the line ‘Net trading result’ in the statement of income.

Erste Bank makes use of the option to designate some financial liabilities as measured at FVPL at initial recognition (referred to as fair value option) if:

- such classification eliminates or significantly reduces an accounting mismatch between the financial liability otherwise measured at amortised cost and the related derivative measured at FVPL; or
- the entire hybrid contract is designated at FVPL due to the existence of a non-closely related embedded derivative.

On the balance sheet debt instrument financial liabilities and derivatives are reported in line item ’Financial liabilities held for trading‘, sub-items ‚Other financial liabilities held for trading‘ and ‚Derivatives‘. In line item ‚Financial liabilities at fair value through profit or loss‘ contains sub-item ‚Debt securities issued‘. Interest incurred is reported in the statement of income under in line item ‘Other similar expenses’ under ‘Net interest income’. Gains and losses resulting from changes in fair value are recognised net of the interest expense under the line item ‘Gains/losses from financial instruments measured at fair value through profit or loss’.

The amount of the fair value change resulting from the credit risk of the financial liability for the period is presented as OCI in the statement of comprehensive income in the line ‘Own credit risk reserve’. The cumulative amount is recognised as accumulated OCI, specifically under ‘Own credit risk reserve’ in the statement of changes in equity. The amount recognised in OCI is never reclassified to profit or loss. However, upon derecognition (mainly repurchases) of the financial liabilities designated at FVPL the amount accumulated in OCI is transferred to retained earnings.

The cumulative amount recognised in OCI is calculated as the difference between the present value of the liability determined by using the original credit spread and the fair value of the liability. When calculating the present value of the liability by using the original credit spread the rate used for discounting is the sum of the observed interest rate (swap yield curve) and the original credit spread. The original credit spread is determined at initial recognition of the liability and it equals the difference between the total yield of the liability and the observed interest rate (swap yield curve) at that time. For the purpose of calculation of the present value of the liability, the original credit spread remains fixed over the whole life of the liability. The amount of fair value change attributable to changes in credit risk of the liability for the period which is recognised in OCI is the difference between the cumulative amount of the credit risk at the end of the period and at the beginning of the period.

.

Classification, subsequent measurement and balance sheet line items of financial instruments under IAS 39

As regards the comparative period information on financial instruments in accordance with IAS 39, Erste Bank uses the following categories of financial instruments:

- financial assets or financial liabilities at fair value through profit or loss;
- available-for-sale financial assets;
- held-to-maturity investments;
- loans and receivables; and
- financial liabilities measured at amortised cost.

The line items as presented on the balance sheet do not necessarily correspond with the IAS 39 categories of financial instruments. The correspondence between the balance sheet line items and the categories of financial instruments is described in the table at item (ix).

i. Cash and cash balances in the comparative period

Cash balances include only claims (deposits) against central banks and credit institutions that are repayable on demand. Repayable on demand means that they may be withdrawn at any time or with a term of notice of only one business day or 24 hours. Mandatory minimum reserves are also shown under this item.

ii. Derivative financial instruments in the comparative period

Please refer to the part 'Derivative financial instruments' below.

iii. Financial assets and financial liabilities – held for trading in the comparative period

Financial assets and financial liabilities – held for trading comprise derivatives and other trading assets and liabilities. The treatment of derivatives – held for trading is discussed in the part Derivative financial instruments below.

Other trading assets and liabilities are non-derivative instruments. They include debt securities as well as equity instruments acquired or issued principally for the purpose of selling or repurchasing in the near term. In the balance sheet, they are presented as 'Other trading assets' or 'Other trading liabilities' under the heading 'Financial assets/financial liabilities – held for trading'.

Changes in fair value (clean price for debt instruments) resulting from other trading assets and liabilities are reported in the statement of income under the line item 'Net trading result'. Interest income and expenses are reported in the statement of income under the line item 'Net interest income'. Dividend income is shown under the line item 'Dividend income'.

If securities purchased under an agreement to resell or borrowed through securities lending transactions are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within 'Other trading liabilities'.

iv. Financial assets or financial liabilities designated at fair value through profit or loss in the comparative period

Financial assets or financial liabilities classified in this category under IAS 39 are those that were designated by management on initial recognition (fair value option).

In 2017 Erste Bank used the fair value option in the case of financial assets managed on a fair value basis. In accordance with a documented investment strategy, the performance of the portfolio is evaluated and regularly reported to the management board.

Financial liabilities designated at fair value through profit or loss are reported on the balance sheet under the line item 'Financial liabilities designated at fair value through profit or loss' further broken down into 'Deposits from customers' and 'Debt securities issued'. Changes in fair value are recognised in the statement of income under the line item 'Gains/losses from financial assets and liabilities measured at fair value through profit or loss'. Interest incurred is reported under the line item 'Net interest income'.

.

v. Financial assets available for sale in the comparative period

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

Available-for-sale financial assets are measured at fair value. On the balance sheet, available-for-sale financial assets are disclosed under the line item ‘Financial assets available for sale’.

Unrealised gains and losses are recognised in OCI and reported in the ‘Available for sale reserve’ until the financial asset is disposed of or impaired. If available-for-sale assets are disposed of or impaired, the cumulative gain or loss previously recognised in OCI is reclassified to profit or loss and reported in the line item ‘Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net’ in the case of sale or in the line item ‘Net impairment loss on financial assets’ in the case of impairment.

Interest income on available-for-sale financial assets is reported under the line item ‘Net interest income’. Dividend income is reported under the line item ‘Dividend income’.

In 2017, as part of the IFRS 9 implementation, valuation models were developed for investments in unquoted equities that were previously measured at cost less impairment. Erste Bank and the Group consider that these models deliver reliable, fair value measurement. As a result, these investments were remeasured to fair value throughout 2017. The remeasurement effects are disclosed in Note 17 Financial assets available for sale.

vi. Financial assets held to maturity in the comparative period

Under IAS 39, non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity and reported on the balance sheet as ‘Financial assets held to maturity’ if Erste Bank has the intention and ability to hold them until maturity. After initial recognition, held-to-maturity financial assets are measured at amortised cost. Amortised cost is calculated by taking into account any discount, premium and/or transaction costs that are an integral part of the effective interest rate.

Interest earned on financial assets held to maturity is reported in the statement of income under the line item ‘Net interest income’. Losses arising from impairment of such financial assets are presented as ‘Net impairment loss on financial assets’. Realised gains or losses from selling are recognised in the statement of income under the line item ‘Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net’.

vii. Loans and receivables in the comparative period

The balance sheet line item ‘Loans and receivables to credit institutions’ includes financial instruments that are allocated to the IAS 39 financial instrument category loans and receivables with a contractual maturity of more than 24 hours. The balance sheet line item ‘Loans and receivables to customers’ includes financial instruments that are allocated to the financial instrument category loans and receivables regardless of their contractual maturity. Furthermore, finance lease receivables that are accounted for using IAS 17 are presented under these balance sheet line items.

Under IAS 39, loans and receivables are non-derivative financial assets (including debt securities) with fixed or determinable payments that are not quoted in an active market, other than:

- those that the Bank intends to sell immediately or in the near term and those that Erste Bank upon initial recognition designates as at fair value through profit or loss;
- those that the Bank, upon initial recognition, designates as available for sale; or
- those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration.

After initial recognition, loans and receivables are measured at amortised cost. Finance lease receivables are subsequently measured as specified in the chapter 'Leasing'. Interest income earned is included under the line item ‘Net interest income’ in the statement of income. Impairment losses arising from loans and receivables are recognised in the statement of income under the line item ‘Net impairment loss on financial assets’.

viii. Financial liabilities measured at amortised cost in the comparative period

Financial liabilities are measured at amortised cost unless they are measured at fair value through profit or loss.
For presentation on the balance sheet, the line item 'Financial liabilities measured at amortised cost' is used. The liabilities are further broken down by 'Deposits from banks', 'Deposits from customers', 'Debt securities issued' and 'Other financial liabilities'.

Interest expenses incurred are reported in the line item 'Net interest income' in the statement of income. Gains and losses from derecognition (mainly repurchase) of financial liabilities at amortised cost are reported under the line item 'Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net'.

ix. Relationships between balance sheet items, measurement methods and categories of financial instruments in the comparative period

Balance sheet position	Measurement principle: Fair value	Measurement principle: Amortised cost	Measurement principle: Other	Financial instrument category
Assets				
Cash and cash balances		x	Nominal value	n/a / Loans and receivables
Financial assets - held for trading				
Derivatives	x			Financial assets at fair value through profit or loss
Other trading assets	x			Financial assets at fair value through profit or loss
Financial assets - at fair value through profit or loss	x			Financial assets at fair value through profit or loss
Financial assets - available for sale	x			Available for sale financial assets
Financial assets - held to maturity		x		Held to maturity investments
Loans and receivables to credit institutions		x		Loans and receivables
thereof Finance lease			IAS 17	n/a
Loans and receivables to customers		x		Loans and receivables
thereof Finance lease			IAS 17	n/a
Derivatives - hedge accounting	x			n/a
Liabilities and equity				
Financial liabilities - held for trading				
Derivatives	x			Financial liabilities - at fair value through profit or loss
Other trading liabilities	x			Financial liabilities - at fair value through profit or loss
Financial liabilities - at fair value through profit or loss	x			Financial liabilities - at fair value through profit or loss
Financial liabilities measured at amortised cost		x		Financial liabilities measured at amortised cost
Derivatives - hedge accounting	x			n/a

Furthermore, two additional classes of financial instruments that are not presented in the table above are part of IFRS 7 disclosures. These are financial guarantees and irrevocable credit commitments.

Impairment of financial instruments under IFRS 9

Erste Bank recognises loss allowances for impairment on its debt instrument financial assets, other than those measured at FVPL, its lease receivables, and its off-balance credit risk exposures arising from financial guarantees and certain loan commitments. The impairment is based on expected credit losses whose measurement reflects:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The amount of the impairment loss is recognised as a loss allowance. For the purpose of the measurement of the amount of expected credit loss and recognition of interest income, Erste Bank distinguishes between three stages of impairment.

Stage 1 relates to financial instruments for which no significant increase in credit risk has been recorded since their initial recognition. The impairment is measured in the amount of the 12-month expected credit loss. For 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring. Interest income is recognised by effective interest rate applied to the gross carrying amount of the financial asset.

Financial instruments in Stage 2 are subject to significant increase in credit risk since their initial recognition. The impairment is measured in the amount of the lifetime expected credit loss. For lifetime expected credit losses, Erste Bank estimate the risk of a default occurring on the financial instrument during its expected life. Interest income is recognised by effective interest rate applied to the gross carrying amount of the financial asset (as for Stage 1).

Financial assets in Stage 3 are credit-impaired. In respect of applying the ‘credit-impaired’ concept of IFRS 9, Erste Bank generally adopted the approach of aligning it with the regulatory concept of ‘default’ for lending exposures. The impairment for such financial assets is measured in the amount of lifetime expected credit loss. Interest income is recognised by EIR applied to the amortised cost (i.e. the net carrying amount) of the financial asset. From a balance sheet perspective, interest is accrued based on the financial assets’ gross carrying amount. The difference between the interest accrued on the assets and the interest income recognised is reflected through the allowance account (without impacting the impairment loss).

More detailed information about identification of significant increases in credit risk including collective assessment, estimation techniques used to measure 12-month and lifetime expected credit losses and definition of default is provided in Note 44 Risk management, part Credit risk.

For financial assets measured at amortised cost, the net carrying amount of the financial asset presented on the balance sheet is the difference between the gross carrying amount and the cumulative loss allowance. However, for financial assets measured at FVOCI, the loss allowance is recognised in accumulated OCI, specifically under ‘Fair value reserve’ in the statement of changes in equity. Loss allowances for loan commitments and financial guarantees are presented under the balance sheet line item ‘Provisions’.

For financial assets that are credit-impaired at initial recognition (POCI financial assets) lifetime expected credit losses are initially reflected in the credit-adjusted effective interest rate. As a result, no loss allowance is recognised at inception. Subsequently, only adverse changes in lifetime expected credit losses after the initial recognition are recognised as loss allowance, whilst favourable changes are recognised as impairment gains increasing the gross carrying amount of the POCI financial assets. No impairment stages are distinguished for the POCI financial assets.

In the statement of income, impairment losses and their reversals (gains) on all kinds of financial instruments are presented in the line item ‘Impairment result from financial instruments’.

Impairment of financial assets and credit risk losses of contingent liabilities under IAS 39

Under IAS 39 Erste Bank assessed at each balance sheet date whether there was any objective evidence that a financial asset or group of financial assets was impaired. A financial asset or group of financial assets was deemed to be impaired if, and only if, there was 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) had an impact on the estimated future cash flows of the financial asset or the group of financial assets that could be reliably estimated. Erste Bank uses the CRR definition of default as a primary indicator of loss events.

In order to maximise collection opportunities and minimise the number of defaults, Erste Bank renegotiates loans to customers in financial difficulties (referred to as forbearance cases). Both retail and corporate loans can be subject to forbearance. Under the Erste Bank's forbearance policy, loan forbearance can be granted if the debtor is currently in default or if there is a high risk of default, there is evidence that the debtor made all efforts to pay according to the original contractual terms and it is expected that the debtor is able to meet the revised terms. Revised terms could be extended maturity, instalment reduction, changing the timing of the interest payments, interest reduction or forgiveness, revolving exposure change to instalments.

Loans subject to forbearance are generally not derecognised and are considered for impairment based on renegotiated conditions. However, in certain cases (like for FX loan conversions) when the renegotiation is qualitatively assessed as a substantial extinguishment of the rights to collect the cash flows due to material changes in the timing and amount of the cash flows, the loan is derecognised and the renegotiated loan is recognised as a new loan initially measured at fair value.

For assessment at portfolio level, Erste Bank used the incurred but not reported losses concept under IAS 39. This concept identified the time period between the moment of the loss event causing future problems and actual detection of the problems by the bank at the moment of default.

Credit risk losses resulting from contingent liabilities were recognised if it was probable that an outflow of resources to settle a credit risk bearing contingent liability would occur and that this outflow would result in a loss.

Write-offs

Erste Bank writes off a financial asset or a part of it when it has no reasonable expectations of recovering the respective cash flows. When performing the write-off, the gross carrying amount of the asset is reduced simultaneously with the related loss allowance balance.

Erste Bank has specified criteria for writing off the unrecoverable balances in its loan business. Write-off can result from forbearance measures whereby the bank contractually waives part of the existing balance in order to help the customers overcome financial difficulties and thus improve the prospects of recovering the remaining loan balance (normally this relates to going concern scenarios for corporate customers). In gone concern scenarios with corporate customers, write-offs of the unrecoverable exposure parts are triggered by enforcement activities such as filing or termination of legal proceedings (bankruptcy, liquidation, court case). Other write-off triggers may result from decisions about no enforcement due to worthlessness of the claim/collateral or generally from assessment that the receivable is economically lost. For retail customers, the non-recoverability and the timing and amounts of write-off crystallise during the collection process when it becomes evident that the amount due cannot be collected, e.g. due to ongoing bankruptcy proceedings. Residual uncollectable balances are written off after the collection process.

Derecognition of financial instruments including treatment of contractual modifications

i. Derecognition of financial assets

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

- the contractual rights to receive cash flows from the asset have expired; or
- Erste Bank 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:

- it has transferred substantially all risks and rewards connected with ownership of the asset, or
- has neither transferred nor retained substantially all risks and rewards connected with ownership of the asset but has transferred control of the asset.

The difference between the carrying amount of the derecognised asset and the consideration received is presented in the statement of income in the line 'Gains/losses from derecognition of financial assets measured at amortised cost' or, for financial assets at FVOCI, in the line

'Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss'. For financial assets measured at FVPL the derecognition gains or losses are recognised together with the measurement result in the lines 'Net trading result' or 'Gains/losses from financial instruments measured at fair value through profit or loss'.

In the comparative period, line items 'Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net', 'Result from financial assets and liabilities designated at fair value through profit or loss' and 'Net trading result' are used depending on the measurement category of the derecognised financial assets.

ii. Derecognition criteria with respect to contractual modifications of financial assets
In the normal course of running its lending business and in agreement with the respective debtors, Erste Bank may renegotiate or otherwise modify some terms or conditions of the underlying contracts. This can involve either market-driven commercial renegotiations or contractual changes aimed at alleviating or preventing borrower's financial difficulty. For the purpose of capturing the economic substance and financial effect of such contractual modifications, Erste Bank has developed a set of criteria to assess whether or not the modified terms are substantially different from the original terms. While having been partly applied in the IAS 39 environment (see description of forbearance and related derecognitions above in the part 'Impairment of financial assets and credit risk losses of contingent liabilities under IAS 39'), these criteria have been further adapted to concepts brought by IFRS 9, e.g. modification of contractual cash flows.

Substantial modifications lead to derecognition of the original financial asset and initial recognition of the modified financial asset as a new financial instrument. They include following events:

- change of the contractual counterparty (unless this is a formal change such as changes in legal name);
- change in the currency of the contract (unless the change results from exercising an embedded option in the original contract with pre-agreed conditions of the change, or if the new currency is pegged to the original currency);
- introduction of a non-SPPI contractual feature (unless it is intended to improve recoveries from debtors by granting concessions supporting them to recover from financial difficulties); and
- removal of a non-SPPI contractual feature.

Some derecognition criteria distinguish whether contractual modifications are applied to debtors facing financial difficulties. Application of certain modifications to debtors in financial difficulties is not considered as substantial since they are aimed at improving the prospects of the bank to recover the claims by tailoring the repayment schedules to specific financial conditions of those debtors. On the other hand, such contractual modifications applied to performing debtors may be considered as substantial enough to warrant the derecognition, as further detailed below.

From this perspective, the following criteria lead to derecognition unless they are considered as forbearance measures, they are applied to customers in default or they trigger default:

- repayment schedule changed in a way that the weighted remaining maturity of the assets is modified by more than 100% and not less than two years compared to the original asset;
- change in timing/amount of contractual cash flows resulting in the present value of the modified cash flows (discounted at pre-modification effective interest rate) being different by more than 10% of the gross carrying amount of the asset immediately before the modification (cumulative assessment considering all modifications occurring over the last twelve months); or
- commercial renegotiations initiated by a debtor seeking better terms as an alternative to re-financing while a prepayment/early termination option and a sufficiently competitive refinancing market exist. Furthermore, the costs that the debtor would incur in case of prepayment/early termination would have to be assessed as sufficiently low for not deterring it. This derecognition trigger rarely applies to loan assets in Stage 2 and never in Stage 3.

If contractual modifications that qualify as forbearance measures are applied to customers in default or trigger default are so significant that they are qualitatively assessed as an extinguishment of original contractual rights, they result in derecognition. Examples of such modifications are:

- a new agreement with materially different terms signed up as part of distressed restructuring following a standstill agreement suspending the rights of the original assets;
- consolidation of multiple original loans into one with substantially different terms; or
- transformation of a revolving loan into non-revolving.

Contractual modifications leading to derecognition of the related original assets result in the initial recognition of new financial assets. If the debtor is in default or the significant modification leads to the default, then the new asset will be treated as POCI. The difference between the carrying amount of the derecognised asset and initial fair value of the new POCI asset is presented in the statement of income in the line 'Impairment result from financial instruments'.

If the debtor is not in default or the significant modification does not lead to default, the new asset recognised after derecognition of the original asset will be in Stage 1. For loans measured at amortised cost, the unamortised balance of the origination fees/transaction costs considered in the effective interest rate is presented in the line 'Net interest income' at the derecognition date. The release of the credit loss allowance attached to the original asset at the date of that significant modification as well as the credit loss allowance recognised for the new asset are presented in the line 'Impairment result from financial instruments'. The remaining difference is presented in the line 'Gains/losses from derecognition of financial assets measured at amortised cost'.

For financial assets measured at FVPL, irrespective of whether they are in default, the derecognition gains and losses are included in the same line items of the statement of income as their measurement result, i.e. in 'Gains/losses from financial instruments measured at fair value through profit or loss'.

For debt instrument assets not measured at FVPL that are subject to contractual modifications that do not result in derecognition, the gross carrying amount of the asset is adjusted against recognising a modification gain or loss in profit or loss. The modification gain or loss equals the difference between the gross carrying amount before the modification and the present value of the cash flows based on the modified terms discounted with the original effective interest rate. In the statement of income, the modification gain or loss is presented in the line 'Interest income' under 'Net interest income' if the modification relates to financial assets in Stage 1. For financial assets in Stage 2 and 3 and POCI financial assets, the modification gain or loss is presented in the line 'Impairment result from financial instruments'. However, to the extent that the contractual modification involves the bank giving up its rights of collecting cash flows in respect of an outstanding amount of the asset, such as waiving (part of) principal or accrued interest amount, it is treated as a write-off.

iii. Derecognition of financial liabilities
A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. This normally occurs when the liability is repaid or repurchased. In the statement of income, the difference between the carrying amount of the derecognised financial liability and the consideration paid is presented in the line 'Other gains/losses from financial instruments not measured at fair value through profit or loss' (in the comparative period, 'Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net'), 'Gains/losses from financial instruments measured at fair value through profit or loss' and 'Net trading result' depending on the measurement category of the derecognised financial liability.

Derivative financial instruments

Derivative financial instruments are used by Erste Bank to manage exposures to interest rates, foreign currencies and other market price risks. Derivatives used by Erste Bank include mainly interest rate swaps, futures, forward rate agreements, interest rate options, currency swaps and currency options as well as credit default swaps.

For presentation purposes, derivatives are split into

- Derivatives – held for trading; and
- Derivatives – hedge accounting

Derivative financial instruments are carried at fair value (dirty price) on the balance sheet. Derivatives are carried as assets if their fair value is positive and as liabilities if their fair value is negative.

Derivatives – held for trading are those that are not designated as hedging instruments for hedge accounting. They are presented in the line item 'Derivatives' under the heading 'Financial assets/Financial liabilities held for trading'. All kinds of non-hedging derivatives without regard to their internal classification, i.e. both derivatives held in the trading book and banking book, are presented in this line item.

Changes in the fair value (clean price) of derivatives – held for trading are reported in the statement of income in the line item 'Net trading result'. Interest income/expense related both to held for trading and hedging derivatives is presented in the statement of income in the line item 'Other similar income' or 'Other similar expenses' under 'Net interest income'. Interest income/expense recognition is based on EIR-like accruals based on the derivative notional amount and includes amortisation of the inception value of the derivative (e.g. up-front fees, if any). Presentation under 'Net interest income' line item is applied from 2018 on a voluntary and retrospective basis.

Repurchase and reverse repurchase agreements

Transactions involving sales of securities under an agreement to repurchase them at a specified future date are also known as 'repos' or 'sale and repurchase agreements'. Securities sold in such transactions are not derecognised from the balance sheet, as Erste Bank retains substantially all risks and rewards of ownership, because the securities are repurchased at a fixed price when the repo transaction ends. Furthermore, Erste Bank is the beneficiary of all coupons and other income payments received on the transferred assets over the period of the repo transactions. These payments are remitted to Erste Bank or are reflected in the repurchase price.

The cash received upon sale of securities is recognised on the balance sheet with a corresponding obligation to return under the line item 'Financial liabilities measured at amortised cost', sub-items 'Deposits from banks' or 'Deposits from customers' reflecting the transaction's economic substance as a loan to Erste Bank. The difference between the sale and repurchase prices is treated as interest expense and recorded in the statement of income in the line item 'Interest expenses' under 'Net interest income' and is accrued over the life of the agreement. Financial assets transferred out by Erste Bank under repurchase agreements remain on the Bank's balance sheet and are presented separately under the original balance sheet items in the 'thereof pledged as collateral' lines. The measurement category of the transferred financial assets does not change.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised on the balance sheet. Such transactions are also known as 'reverse repos'. The consideration paid is recorded on the balance sheet under the line item 'Financial assets at amortised cost', sub-items 'Loans and advances to banks' and 'Loans and advances to customers' reflecting the transaction's economic substance as a loan by Erste Bank. For the comparative period the balance sheet lines 'Loans and receivables to credit institutions' or 'Loans and receivables to customers' are used in this place. The difference between the purchase and resale prices is treated as interest income and is accrued over the life of the agreement and recorded in the statement of income in the line item 'Interest income' under 'Net interest income'.

Securities lending and borrowing

In securities lending transactions, the lender transfers ownership of securities to the borrower on the condition that the borrower will re-transfer, 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.

Hedge accounting (on IAS 39 basis)

Erste Bank 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 amortisation of the fair value adjustment shall be done based on a recalculated effective interest rate at the date amortisation 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 amortised 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 Bank, no hedging relationship has been designated 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.

Financial guarantees

In the ordinary course of business, Erste Bank provides financial guarantees, consisting of various types of letters of credit and guarantees. A financial guarantee is a contract that requires the guarantor to make specified payments to reimburse the holder for a loss it incurs in case a specified debtor fails to make a payment when due in accordance with the original or modified terms of a debt instrument. If Erste Bank is in the position of being a guarantee holder, the financial guarantee is not recorded on the balance sheet but is taken into consideration as collateral when determining the impairment of the guaranteed asset.

Erste Bank as a guarantor recognises financial guarantees as soon as it becomes a contracting party. Financial guarantees are initially measured at fair value. Generally, the initial measurement is the premium received for a guarantee. This amount is subsequently amortised to fee income. They are presented on the balance sheet under the line 'Provisions'. In the comparative period, the financial guarantee contracts were reviewed for the possibility that provision recognition under IAS 37 was required. The premium received is recognised in the statement of income under the line item 'Fee and commission income' under 'Net fee and commission income' on a straight-line basis over the life of the guarantee.

IFRS 15 Revenue from Contracts with Customers

As of 1 January 2018, Erste Bank has adopted IFRS 15 'Revenue from Contracts with Customers'. 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, except for those revenue streams for which other standards like IFRS 9 provide more specific regulations. As a consequence, the standard is not focused on recognition of revenues from financial instruments. For Erste Bank the scope of application is therefore substantially restricted to revenue streams presented under fee and commission income. The adoption of the five step model did not impact the timing or amount of fee and commission income and the related assets and liabilities recognised by the Bank.

Leasing

A lease is an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments. A finance lease at Erste Bank is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. All other lease agreements at Erste Bank are classified as operating leases. This mainly includes the leasing of commercial real estate, automobiles and small trucks.

i. Erste Bank as a lessor

In the case of a finance lease, the lessor reports a receivable from the lessee under the line item ‘Finance lease receivables’. The receivable is equal to the present value of the contractually agreed payments taking into account any residual value. Interest income on the receivable is reported in the statement of income in the line item ‘Interest income’ under ‘Net interest income’.
‘Finance lease receivables’ are separated on a voluntary basis from 2018, while in 2017 presented under line item ‘Loans and receivables to customers’.

In the case of operating leases, the leased asset is reported by the lessor in ‘Property and equipment’ or in ‘Investment properties’ 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 in the statement of income under the line item ‘Rental income from investment properties & other operating leases’.

The vast majority of lease agreements in which Erste Bank operates as a lessor are finance leases.

ii. Erste Bank as a lessee

As a lessee, Erste Bank has not entered into any leases meeting the conditions of finance leases. Operating lease payments are recognised as an expense in the statement of income on the line item ‘Other administrative expenses’ on a straight-line basis over the lease term.

Property and equipment

Property and equipment is measured at cost less accumulated depreciation and accumulated impairment. 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. Depreciation is recognised in the statement of income on the line item ‘Depreciation and amortisation’ and impairment under the line item ‘Other operating result’.
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

Land is not depreciated.

Property and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on disposal of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the statement of income under the line item ‘Other operating result’.

Investment properties

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 when 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. Investment property is presented on the balance sheet in the line item 'Investment properties'.

Repossessed assets

Erste Bank 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 Bank does not occupy repossessed assets for business use as it is the policy of Erste Bank 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 minimising 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.

Intangible assets

Erste Bank'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.

Impairments and their reversals are recognised in the statement of income under the line item 'Other operating result'.

Investments in subsidiaries

In this line item investments in subsidiaries are presented. List of subsidiaries see in Note 52.
According to IAS27 the Bank opted to measure its investments at cost.

Non-current assets and disposal groups 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.

Defined employee benefit plans

The defined employee benefit plan operated by Erste Bank 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 Bank does not operate any employee benefit plans for pensions and severance benefits.

Deferred and non-cash payments remuneration of executives officers
The Bank provides both the current year's and the deferred bonus amounts 50% in cash and 50% in the form of phantom shares (non-cash payment). The entitlement to 60% of the bonus in the form of cash determined on the basis of the current year's performance may be acquired during the current year, and 40% is deferred and distributed over 4 years, in equal instalments. The entitlement to 49% of the bonus in the form of phantom shares in cash determined on the basis of the current year's performance may be acquired during the current year, and 51% is deferred and distributed over 4 years, in equal instalments. When paying the deferred bonus of Management Board members the rules of Erste Group must also be taken into account. When a bonus amount exceeds the predefined limit in the Remuneration Policy a ratio of 40% upfront payment and 60% deferral is applied. Still, 50% of all such payments have to be effected in instruments. The effective payment is always in cash (in case of phantom shares as well).

Provisions
Provisions are recognised when Erste Bank 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'.

Trade and other receivables
Under this line item receivables from factoring transaction are presented.
This item is separated on a voluntary basis from 2018, while in 2017 presented within line item 'Loans and receivables to customers'.

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% (same rate in 2017; 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.

Treasury shares and contracts on treasury shares

Equity instruments of Erste Bank that it or any of its subsidiaries acquire (referred to as treasury shares) are deducted from equity. Consideration paid or received on the purchase, sale, issue or cancellation of the Bank’s own equity instruments, including transaction costs, is recognised directly in equity. No gain or loss is recognised in the statement of comprehensive income on the purchase, sale, issue or cancellation of its own equity instruments.

Fiduciary assets

Erste Bank 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 own equity instruments

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

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.

Items of the statement of income

The description and recognition criteria of the line items reported in the statement of income are as follows:

i. Net interest income

Net interest income is broken down into line items of interest income, other similar income, interest expenses and other similar expenses. The distinguishing factor is whether the EIR method is mandatorily applied for recognition of interest income or expense in accordance with IFRS 9.

‘Interest income’ relates to interest revenue from financial assets measured at amortised cost and at fair value through other comprehensive income. It is calculated using the EIR method as discussed in chapter ‘Financial instruments’, ‘Measurement methods for financial instruments’, part ‘i. Amortised cost and effective interest rate’.

‘Other similar income’ captures interest-like sources of income resulting from non-derivative financial assets measured at fair value through profit or loss, held-for-trading derivatives, finance lease receivables and negative interest on financial liabilities.

‘Interest expenses’ relates to interest expense from financial liabilities measured at amortised cost calculated using effective interest rate as discussed in chapter ‘Financial instruments’, ‘Measurement methods for financial instruments’, part (i) Amortised cost and effective interest rate.

‘Other similar expenses’ capture interest-like sources of expense resulting from non-derivative financial liabilities measured at fair value through profit or loss, held-for-trading derivatives, negative interest on financial assets, provisions recognised under IFRS 9 and IAS 37 (unwinding of the time value of the money effect due to passage of time) and net defined liability (net interest cost on severance payment, pension and jubilee obligations) under IAS 19.

As regards types of financial instruments, interest income and other similar income include interest income on loans and advances to banks and customers, on cash balances, and on debt securities in all measurement categories of financial assets. Interest expenses and other similar expenses include interest paid on deposits from customers, deposits from banks, debt securities issued and other financial liabilities in all measurement categories of financial liabilities. Net interest income also includes interest on derivative financial instruments.

Interest income also includes modification gains and losses recognised on financial assets in Stage 1 Further, the unamortised balance of the origination fees/transaction costs upon derecognition of assets in Stage 1 and 2 considered in the effective interest rate is presented as interest income at the derecognition date.

‘Other similar income’ is separated on voluntary basis from 2018 and applied retrospectively in the financial statement of 2018.

ii. Net fee and commission income
Erste Bank earns fee and commission income from a diverse range of services that it provides to its customers. The determination of the timing and amount of income recognition follows the five step model of IFRS 15.

Fee and commission income is measured based on the consideration specified in the contract with a customer. Erste Bank recognises revenue when it transfers control over a service to a customer.

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commitment fees, guarantee fees and other fees from lending business, commission income from asset management, custody and other management and advisory fees as well as fees from insurance brokerage, building society brokerage and foreign exchange transactions. Payment services partly include fees for services satisfied over a period of time like periodic card fees.

Fee income earned from providing transaction services, such as arranging the acquisition of shares or other securities or the purchase or sale of businesses, is recognised upon completion of the underlying transaction. Payment services partly include transaction based fees like withdrawal fees.

A contract with a customer that results in a recognised financial instrument in the Bank’s financial statement may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then Erste Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual. Fees and commission income that are integral to the effective interest rate of a financial instrument are in the scope of IFRS 9 and are included in the effective interest rate.

iii. Dividend income
Dividend income is recognised when the right to receive the payment is established. This line item includes dividends from all shares and other equity investments, i.e. from those that are held for trading, non-trading equity instruments at FVPL and at FVOCI.

iv. Net trading result

Results arising from trading activities include all gains and losses from changes in the fair value (clean price) of financial assets and financial liabilities classified as held for trading, including all derivatives not designated as hedging instruments. The net trading result also includes any ineffective portions recorded in fair value and cash flow hedge transactions as well as foreign exchange gains and losses on all monetary assets and liabilities.

v. Gains/losses from financial instruments measured at fair value through profit or loss

Changes in fair value (clean price) of non-trading financial assets at fair value through profit or loss, including gains and losses on their derecognition, are presented under this line item. This concerns both non-trading financial assets designated and those mandatorily measured at FVPL. Gains and losses (clean price) of financial liabilities designated at FVPL, including gains and losses on their derecognition, are also presented under this line item. However, the fair value changes resulting from credit risk of the liability are recognised in OCI. In the comparative period this line item includes only changes in fair value (clean price, including the effect of credit risk of the liability) of financial assets and liabilities designated at FVPL.

vi. Rental income from investment properties and other operating leases

Rental income from investment properties and other operating leases is recognised on a straight-line basis over the lease term.

vii. Personnel expenses

Personnel expenses include wages and salaries, bonuses, statutory and voluntary social security contributions, staff-related taxes and levies. Furthermore, restructuring provisions expenses may be part of personnel expenses.

vii. Other administrative expenses

Other administrative expenses include primarily information technology expenses, expenses for office space, office operating expenses, advertising and marketing, and expenditures for legal and other consultants. Furthermore, the line item contains deposit insurance contributions expenses. Restructuring provisions expenses may also be presented in other administrative expense

ix. Depreciation and amortisation

This line item comprises depreciation of property and equipment, depreciation of investment property and amortisation of intangible assets.

x. Gains/losses from derecognition of financial assets measured at amortised cost

This line item includes selling and other derecognition gains or losses on financial assets measured at amortised cost. However, if such gains/losses relate to derecognition of financial assets in Stage 3, they are included in the line item 'Impairment result from financial instruments'.

xi. Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss

This line item includes selling and other derecognition gains or losses on financial assets at FVOCI, financial liabilities measured at amortised cost and other financial instruments not measured at FVPL, such as finance lease receivables or financial guarantees. However, if such gains/losses relate to financial assets in Stage 3 they are included in the line item 'Impairment result from financial instruments'.

xii. Impairment result from financial instruments

Net impairment losses on financial instruments comprise impairment losses and reversals of impairment on all kinds of financial instruments, to which the IFRS 9 expected credit loss impairment model applies. The impairment result also includes recoveries on written-off financial assets. Modification gains and losses recognised on financial assets in Stage 2 and Stage 3 and POCI assets are also presented as the impairment result. Moreover, gains/losses from derecognition of financial assets in Stage 3 and POCI assets are included as part of the impairment result.

xiii. Other operating result

Other operating result reflects all other income and expenses not directly attributable to Erste Bank's ordinary activities. Furthermore, levies on banking activities are considered as part of the other operating result. Other operating result includes impairment losses or any reversal of impairment losses as well as results on the sale of property and equipment and intangible assets.

.

In addition, other operating result encompasses the following: expenses for other taxes; income from the release of and expenses for allocations to provisions; impairment losses (and their reversal if any) as well as selling gains and losses on equity investments accounted for using the equity method; and gains or losses from derecognition of subsidiaries. In the comparative period, other operating result also included income from the release of and expenses for allocations to provisions for credit risk.

There are two additional line items in the statement of income that are relevant only for the comparative period:

xiv. Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net in the comparative period
This line item includes selling and other derecognition gains or losses on available-for-sale and held-to-maturity financial assets, loans and receivables and financial liabilities measured at amortised cost. However, if such gains/losses relate to individually impaired financial assets they are included as part of the net impairment loss.

xv. Net impairment loss on financial assets in the comparative period
Net impairment losses on financial assets comprise impairment losses and reversals of impairment on loans and receivables, held-to-maturity and available-for-sale financial assets. Net impairment losses relate to allowances recognised both at individual and portfolio (incurred but not reported) level. Direct write-offs are considered as part of impairment losses. This line item also includes recoveries on written-off loans removed from the balance sheet.

d) Significant accounting judgements, assumptions and estimates

The 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 uses of judgements, assumptions and estimates are as follows:

SPPI assessment

The assessment of whether the contractual cash flows of financial assets give rise to cash flows that are solely payments of principal and interest (SPPI) is subject to the application of significant judgements which rely on the guidance in IFRS 9. These judgements are crucial in the IFRS 9 classification and measurement process as they determine whether the asset must be measured at FVPL or, depending on the business model assessment, at amortised cost or at FVOCI. When taking into consideration specific features of loans in the business of Erste Bank, significant areas of judgement are prepayment fees, project financing loans and benchmark test for loans with interest mismatches features.

The assessment whether the prepayment fees applied to loans can be considered as a reasonable compensation for early terminations or prepayments is based on comparing the level of the fees with the economic costs incurred by the bank upon the early termination. The adequacy of the fees can also be defended on a qualitative basis such as common market practice regarding level prepayment fees and their acceptance by authorities.

For project financing loans Erste Bank assesses whether they represent basic loan agreements rather than investments in the financed projects. In this respect, credit rating, level of collateralisation, existing sponsor guarantees and the extent of equity funding of the financed projects are considered.

The most critical area of SPPI judgements in the business of Erste Bank comprises retail loans with a government subsidy element granted to the customer priced in a way that contractual cash flows characteristics contain a leverage. Qualitative benchmark test proved that the leverage identified increases the variability of contractual cash flows with the result that they do not have the economic characteristics of interest.

Business model assessment

For each SPPI-compliant financial asset at initial recognition, Erste Bank must assess whether it is part of a business model where the assets are held in order to collect contractual cash flows, to both collect the contractual cash flows and sell the assets, or they are held in other business models. As a consequence, the critical aspect in distinguishing the business models is frequency and significance of sales of assets in the respective business model. Since asset allocation to business models is based on the initial assessment, it may happen that in subsequent periods cash flows are realised differently than originally expected, and a different measurement method may seem to be appropriate. In accordance with IFRS 9, such subsequent changes do not generally lead to reclassifications or prior period error corrections in respect of existing financial assets. The new information on how cash flows are realised may, however, indicate that the business model, and thus the measurement method changes for newly acquired or newly originated financial assets.

At Erste Bank, 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 or tax environment, major internal reorganisation or a business combination, severe liquidity crisis, etc.) are considered as not contradicting the held to collect contractual cash flows business model. Other kinds of sales carried out in the 'held to collect' business model are assessed retrospectively, and if they exceed certain quantitative thresholds, or whenever it is considered necessary with regard to new expectations, Erste Bank performs a prospective test. If the outcome was that the carrying amount of assets expected to be sold over the expected life of the current business model portfolio, for reasons other than the cases above, exceeds 10% of the carrying amount of the portfolio, any new acquisitions or originations of assets would be classified in a different business model.

Impairment of financial instruments

The expected credit loss impairment model is inherently based on judgement since it requires assessment of significant increases in credit risk and measurement of expected credit losses without providing detailed guidance. In respect of significant increases in credit risk, Erste Bank has determined specific assessment rules consisting of qualitative information and quantitative thresholds. Another area of complexity relates to establishing groups of similar assets when credit risk deterioration has to be assessed on a collective basis before specific information is available at individual instrument level. Measurement of expected credit losses involves complex models relying on historical statistics of probabilities of default and loss rates in case of defaults, their extrapolations in case of insufficient observations, individual estimates of credit-adjusted cash flows and probabilities of various scenarios including forward-looking information. In addition, the life of the instruments has to be modelled in respect of behavioural life of revolving credit facilities.

Under the IAS 39 incurred loss impairment model used for the comparative period, Erste Bank reviewed 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 statement of income. In particular, this involved determining whether there is objective evidence of impairment as a result of a loss event occurring after initial recognition and estimating the amount and timing of future cash flows when determining an impairment loss.

Detailed disclosures about identification of significant increases in credit risk including collective assessment, estimation techniques used to measure 12-month and lifetime expected credit losses and definition of default is provided in Note 44 Risk management, part Credit risk. The development of loan loss provisions is described in Note 18 Financial assets at fair value through other comprehensive income, Note 23 Financial assets at amortised cost, and Note 26 Finance lease receivables. The development of loan loss provisions in the comparative period is included in Note 21 Loans and receivables to credit institutions and Note 22 Loans and receivables to customers.

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 45) Fair value of financial and non-financial instruments.

Impairment of non-financial assets

Erste Bank reviews its non-financial assets at each balance sheet date to assess whether there is an indication of impairment loss that should be recorded in the statement of income. Furthermore, cash-generating units to which goodwill is allocated are tested for impairment on a yearly basis. Judgement and estimates are required to determine the value in use and fair value less costs of disposal 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 in Note 30 Tax assets and liabilities.

Provisions

Recognition of provisions requires judgement with respect to whether Erste Bank has a present obligation as a result of a past event and whether it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Furthermore, estimates are necessary with respect to the amount and timing of future cash flows when determining the amount of provisions. Provisions are disclosed in Note 34 Provisions, and further details on provisions for contingent credit liabilities in Note 44 Risk Management, part credit risk. Legal proceedings that do not meet the criteria for recognition of provisions are described in Note 47 Contingent liabilities.

e) 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 2018. As regards new standards and interpretations and their amendments, only those that are relevant for the business of Erste Bank are listed below.

Effective standards and interpretations

The following standards, their amendments and interpretation have become mandatory for our financial year 2018, 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;
- Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions;
- Amendments to IAS 40: Transfers of Investment Property;
- Annual Improvements to IFRSs 2014-2016 Cycle (amendments to IAS 28 and IFRS 1);
- IFRIC 22: Foreign Currency Transactions and Advance Consideration.

The effects of application of IFRS 9 and IFRS 15 are described in chapter ‘c) Accounting and measurement methods’ above. Otherwise application of the above mentioned amendments and interpretation did not have a significant impact on the Bank’s financial statements.

Standards and interpretations not yet effective

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

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

- IFRS 16: Leases
- Amendments to IFRS 9: Prepayment features with negative compensation
- IFRIC 23: Uncertainty over Income Tax Treatments

Following standards, amendments and interpretations have not yet been endorsed by the EU until 4 April 2019:

- Amendments to IFRS 3: Definition of a Business
- Amendments to IAS 1 and IAS 8: Definition of Material
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement
- Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures
- Annual Improvements to IFRSs 2015-2017 Cycle (amendments to IFRS 3, IFRS 11, IAS 12 and IAS 23)

IFRS 16: Leases. In January 2016, the IASB issued IFRS 16 which is effective for annual periods beginning on or after 1 January 2019. IFRS 16 replaces existing guidance for accounting for leases in IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a lease, SIC-15 Operating leases – Incentives and SIC-27 Evaluation the Substance of Transactions Involving the Legal Form of a lease.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases (less than 12 months) and leases of low-value items.

At inception date of a contract, the contract is assessed for whether it contains a lease, i.e. whether the contract conveys the right to control the use of an identified asset for a period of the time in exchange for a consideration. A right-of-use asset and a lease liability are recognised at the lease commencement date. It is initially measured at cost and subsequently depreciated from the commencement date to the earlier of the end of its useful life or the end of the lease term. Erste Bank will use the straight-line method of depreciation.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if the rate cannot be readily determined, the lessee's incremental borrowing rate. Lease payments comprise fixed lease payments, variable lease payments that depend on an index or a rate, amounts expected to be payable under a residual value guarantee, the exercise price under a purchase option and lease payments in an optional renewal period if the lessee is reasonably certain to exercise the options and penalties for early termination if the lease term reflects the lessee exercising the termination option.

Subsequently the carrying amount of the lease liability is increased by interest using the applicable discount rate, reduced by lease payments made and remeasured to reflect any reassessment or lease modification. For leases of movables by Erste Bank entities the incremental borrowing rate will consist of a base rate, which is the Euribor, adjusted by a surcharge based on the entity's rating, the amount of funds borrowed, the term of the lease and the collateral provided. The determination of the incremental borrowing rate for property leases shall generally be based on a rate that is readily observable. Such a rate might be the property yield reflecting the annual return expected on the property. Further, an adjustment to the property yield is necessary to reflect specific features of an entity or the lease agreement (such as creditworthiness and lease term).

Lessor accounting remains similar to the current IAS 17 standard, i.e. the lessor continues to classify leases as finance or operating leases. Compared to IAS 17 the notes will be much more comprehensive under IFRS 16.

Erste Bank will transit to IFRS 16 using the modified retrospective approach according to IFRS 16.C5 (b) whereby comparative information will not be restated. For leases previously classified as operating leases, the applicable discount rate will be the lessee's incremental borrowing rate determined at the date of initial application. The right-of-use asset will be recognised at an amount equal to the lease liability (IFRS 16.C8 (b)(ii)). As a result, Erste Bank does not expect any impact on the equity at initial application. All contracts which were previously identified as leases applying IAS 17 and IFRIC 4 will be taken over into IFRS 16. Erste Bank will not apply IFRS 16 to any leases on intangible assets. Erste Bank will use the exemption for short term leases and leases of low value whereby the right-of-use-asset is not recognised. The analysis and planning of proper IT solutions for requirements of IFRS 16 have continued throughout 2017 and 2018. At the same time the contract analysis has been in focus. The role out of proper IT structure was realised during 2018.

Based on currently available information, Erste Bank estimates at the transition date to IFRS 16 that the right of use assets and lease liabilities will increase the balance sheet by an amount of approximately 14-15 billion forint. The vast majority (more than 95%) of the lease contracts refer to real estate. Lease liabilities are defined on a discounted basis and contracts with maturity less than 1 year are out of the scope conform to IFRS 16 requirements.

Amendments to IFRS 3: Definition of a Business. Amendments to IFRS 3 were issued in October 2018 and are effective for annual periods beginning on or after 1 January 2020. The amendments clarify the three elements, i.e. inputs, process and outputs in the definition of a business. To be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. Also, the amendments include an optional concentration test to permit a simplified assessment of whether an acquired set of activities and assets is an asset acquisition rather than a business combination. The test is met if substantially all of the fair value of the gross assets is concentrated in a single identifiable asset or a group of similar identifiable assets. Application of these amendments is not expected to have a significant impact on Erste Bank's financial statements.

Amendments to IFRS 9: Prepayment features with negative compensation. Amendments to IFRS 9 were issued in October 2017 and are effective for annual periods beginning on or after 1 January 2019. The amendments clarify that the contractual terms of a debt instrument are payments of principal and interest even if the reasonable compensation for an early termination of the instrument is negative, i.e. it has to be paid by the creditor. Further, the amendments explain that the requirements for accounting for modification gains or losses also apply to cases when financial liabilities are modified or exchanged and this does not lead to their derecognition. Application of these amendments is not expected to have a significant impact on Erste Bank's financial statements.

Amendments to IAS 1 and IAS 8: Definition of Material. Amendments to IAS 1 and IAS 8 were issued in October 2018 and are effective for annual periods beginning on or after 1 January 2020. The amendments clarify that information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Application of these amendments is not expected to have a significant impact on Erste Bank's financial statements.

Amendments to IAS 19: Plan Amendment, Curtailment or Settlement. 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 Bank's financial statements.

Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures. 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 Bank's financial statements.

Annual Improvements to IFRSs 2015-2017 Cycle. 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 Bank's financial statements.

IFRIC 23: Uncertainty over Income Tax Treatments. 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 Bank's financial statements.

IFRS 17 "Insurance Contracts" IFRS 17 was 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 IFRS 17 is not expected to have a significant impact on Erste Banks's financial statements.

F. NOTES TO THE FINANCIAL STATEMENTS

1) Net interest income

in HUF million	2017	2018
Financial assets HTM	12,437	x
Loans and receivables	54,729	x
Financial assets at AC	x	64,842
Financial assets AFS	2,422	x
Financial assets at FVOCI	x	2,719
Finance lease receivables	x	776
Interest income	69,588	68,337
Non-trading financial assets at FVPL	x	4,219
Financial assets HFT	4,986	4,946
of which: Derivatives	3,027	3,954
Negative interest from financial liabilities	-	964
Other similar income	4,986	10,129
Interest and other similar income	**74,574**	**78,466**
Financial liabilities at AC	(6,686)	(7,182)
Interest expenses	(6,686)	(7,182)
Financial liabilities at FVPL	(461)	-
Financial liabilities HFT	(1,536)	(4,265)
of which: Derivatives	(1,536)	(4,265)
Derivatives - hedge accounting, interest rate risk	-	-
Other liabilities	(1,338)	(43)
Negative Interest from financial assets	-	(121)
Other similar expenses	(3,335)	(4,429)
Interest and other similar expenses	**(10,021)**	**(11,611)**
Net interest income	**64,553**	**66,855**

The interest income related to the non-performing portfolio is 1,638 million forint in 2018 and 1,682 million forint in 2017.

Modification losses of financial instruments allocated to Stage 1 in the amount of 123 million forint is reported in line item ‘Financial assets at AC’.

Since December 2014, important benchmark interest rates – particularly Euribor – turned negative. This development affected interest income and interest expense of Erste Bank. Negative interest from financial liabilities and financial assets are shown in a separate line. The amounts relate to the interbank business and deposits with central banks only.

2) Net fee and commission income

in HUF million	2017		2018	
	Income	Expenses	Income	Expenses
Securities	12,108	(411)	13,128	(151)
Issues	-	-	-	(101)
Transfer orders	10,530	(411)	11,531	(50)
Other	1,578	-	1,597	-
Custody	-	(252)	-	(232)
Payment services	34,990	(7,917)	38,360	(7,518)
Card business	13,529	(5,608)	14,713	(4,873)
Other	21,461	(2,309)	23,647	(2,645)
Customer resources distributed but not managed	3,557	(18)	4,002	(19)
Insurance products	3,052	(18)	3,104	(19)
Building society brokerage	431	-	838	-
Other	74	-	60	-
Lending business	2,240	(2,342)	2,677	(2,593)
Guarantees given, guarantees received	223	(1)	262	(53)
Loan commitments given, loan commitments received	-	-	6	-
Other lending business	2,017	(2,341)	2,409	(2,540)
Other	348	(1,049)	141	(1,903)
Total fee and commission income and expenses	**53,243**	**(11,989)**	**58,308**	**(12,416)**
Net fee and commission income	**41,254**		**45,892**	

Net fee and commission income above include income of 2,273 million forint relating to financial assets and financial liabilities not measured at FVPL. These figures exclude amounts incorporated in determining the effective interest rate on such financial assets and financial liabilities.

3) Dividend income

in HUF million	2017	2018
Financial assets at FVOCI	81	37
Financial assets at cost	2,500	4,300
Dividend income	**2,581**	**4,337**

4) Net trading result

in HUF million	2017	2018
Securities and derivatives trading	(2,631)	18,096
Foreign exchange transactions	11,049	(4,537)
Net trading result	**8,418**	**13,559**

NBH launched the monetary interest rate swap program (MIRS) in January 2018, available for financial institutions. NBH pays 6 month BUBOR, while the counterparty institution pays a fix interest rate. The participation in the program is unconditional, so the gain, including the ‘day one gain’, is realised in 2018, presented in line items ‘Net trading result’ and ‘Net interest income’. Realised day one gain is amounted to 4 billion forint, presented in ‘Securities and derivatives trading’.

5) Gains/losses from financial instruments measured at fair value through profit or loss

in HUF million	2017	2018
Result from measurement/sale of financial assets designated at FVPL	-	(1,995)
Result from financial assets and liabilities designated at FVPL	**-**	**(1,995)**
Result from measurement/sale of financial assets mandatorily at FVPL	x	(213)
Gains/losses from financial instruments measured at fair value through profit or loss	**-**	**(2,208)**

6) General administrative expenses

in HUF million	2017	2018
Personnel expenses	**(28,040)**	**(27,021)**
Wages and salaries	(21,678)	(20,982)
Compulsory social security	(5,254)	(4,844)
Long-term employee provisions	0	(80)
Other personnel expenses	(1,108)	(1,115)
Other administrative expenses	**(24,661)**	**(23,880)**
Deposit insurance contribution	(1,305)	(1,172)
IT expenses	(8,350)	(9,020)
Expenses for office space[1)]	(6,226)	(5,902)
Office operating expenses	(2,141)	(2,027)
Advertising/marketing	(1,754)	(1,723)
Legal and consulting costs	(2,437)	(1,189)
Sundry administrative expenses	(2,448)	(2,847)
Depreciation and amortisation	**(8,448)**	**(9,712)**
Software and other intangible assets	(5,148)	(6,074)
Owner occupied real estate	(750)	(914)
Customer relationships	(1,169)	(1,274)
Office furniture and equipment and sundry property and equipment	(1,381)	(1,450)
General administrative expenses	**(61,149)**	**(60,613)**

'Expenses for office space' includes rental expense related to headquarter office building and branches, presented in Note 39b, page 78 as operating leasing.

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

in Full Time Employee	2017 year end	2017 average	2018 year end	2018 average
Erste Bank Hungary	**2,827**	**2,868**	**2,903**	**2,858**

.

7) Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net

in HUF million	2017	2018
From sale of financial assets AFS	5,753	x
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	**5,753**	**x**

8) Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss

in HUF million	2017	2018
From sale of financial assets at FVOCI	x	(15)
Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss	**x**	**(15)**

9) Net impairment loss on financial assets

in HUF million	2017	2018
Financial assets AFS	(448)	x
Loans and receivables	2,228	x
Allocation to risk provisions	(28,905)	x
Release of risk provisions	24,861	x
Direct write-offs	(5,432)	x
Recoveries recorded directly to the income statement	11,704	x
Net impairment loss on financial assets	**1,779**	**x**

10) Impairment result from financial instruments

in HUF million	2017	2018
Financial assets at FVOCI	x	(6)
Financial assets at AC	x	6,654
Net allocation to credit loss allowances	x	6,314
Direct write-offs	x	(1,851)
Recoveries recorded directly to the income statement	x	2,573
Modification gains or losses	x	(381)
Finance lease	x	304
Net allocation of credit loss allowances for loan commitments and financial guarantees given	x	55
Impairment result from financial instruments	**x**	**7,007**

11) Other operating result

in HUF million	2017	2018
Other operating expenses	**(44,150)**	**(23,307)**
Allocation/(release) to other provisions[4)]	(20,891)	-
Allocation/(release) to provisions for commitments and guarantees given	-	(458)
Levies on banking activities	(16,919)	(18,384)
Banking tax	(3,801)	(3,904)
Financial transaction tax	(13,118)	(14,480)
Other taxes	(82)	(45)
Recovery and resolution fund contributions[3)]	(705)	(778)
Result from sales of other assets	(5,312)	-
Impairment of properties/movables/other intangible assets other than goodwill	(241)	(1,297)
Result from other operating expenses	-	(2,345)
Other operating income	**37,747**	**7,543**
(Allocation)/release of other provisions	-	900
(Allocation)/release to provisions for commitments and guarantees given[4)]	21,791	-
Government grant[1)]	1,814	1,750
Result from sales of properties/movables/other intangible assets other than goodwill	4,967	63
Result from sales of other assets	0	42
Income from upgrade on loans previously subject to FX settlement[2)]	8,053	4,788
Negative goodwill recognised in profit or loss	374	0
Result from other operating income	748	0
Other operating result	**(6,403)**	**(15,764)**

1) Conforming to its accounting policies (see chapter E. Accounting policies, page 15) Erste Bank 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 35, page 72 .

Erste Bank 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 2018 202 million forint is presented as government grant related to IRS. The 2017 amount equals to 266 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 2018 1,548 million forint is presented as government grant related to HIRS (1,548 million forint in 2017).

2) 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 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.

3) In the line 'Recovery and resolution fund contributions' contributions to the national resolution funds in amount of 778 million (705 million forint in 2017) are disclosed. The contributions are based on the European Recovery and Resolution Directive, which, inter alia, establishes a financing mechanism for the resolution of credit institutions. As a consequence, banks are required to contribute annually to a resolution fund, which in a first step is installed on a national

level. According to these regulations, until 31 December 2024 the available financial means of the resolution funds shall reach at least 1% of the amount of covered deposits of all the credit institutions authorised within the European Union. Therefore the resolution funds have to be built over a period of 10 years, during which the contributions shall be spread out as even as possible until the target level is reached.

4) Erste Bank Hungary was involved into one larger deal which changed its nature from lending business to legal case as continued at court, therefore the large amounts in 2017 relates to the same deal in different stages. Originally allocated impairment in category ‘commitments and guarantees given’ was released when case entered into court phase (‘Release of provisions for commitments and guarantees given‘), while the same amount was allocated in category other provision (‘Allocation to other provision’).

12) 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.

in HUF million	2017	2018
Current tax expense / income		
Current period taxes	(4,343)	(5,047)
of which local business tax	(3,484)	(3,492)
of which local innovation tax	(523)	(524)
Prior period taxes	-	(17)
Deferred tax expense / income		
Current period deferred tax benefit / (expense)	-	3,513
Total	**(4,343)**	**(1,551)**

Deferred tax related to 'Fair Value reserve' has been recognised in other comprehensive income in the amount of 552 million forint in 2018 and related to 'Available for Sale reserve' (299) million forint in 2017.

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

in HUF million	2017	2018
Profit before tax	**56,786**	**59,050**
At statutory income tax rate	(5,111)	(5,315)
Income not subject to tax	1,038	1,679
Non tax deductible expenses	(1,073)	(1,182)
Local business and innovation tax	(4,007)	(4,016)
Tax loss carry forward usage	3,663	2,025
Tax refund related to FX settlement	2,712	-
HAS to IFRS transition difference	-	2,303
Current period deferred tax benefit / (expense)	-	3,513
Other	(1,565)	(558)
Total tax expense	**(4,343)**	**(1,551)**

At 31 December 2018 the tax loss carried forward amounts to 127,549 million forint (2017: 150,050 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 (83,385 million forint);
- Tax loss carry forwards after 31 December 2014 is consumable for a limited period of 5 years, till 31 December 2020 (44,164 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.

Deferred taxes are disclosed in Note 30.

13) Cash and cash balances

in HUF million	2017.01.01	2017.12.31	2018
Cash on hand	17,886	19,792	21,689
Cash balances at central banks	77,116	500	263
Other demand deposits at credit institutions	11,048	1,031	4,893
Cash and cash balances	**106,049**	**21,323**	**26,845**

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 2018 and 31 December 2017 was 16.07 billion forint and 14.35 billion forint respectively. The minimum mandatory reserve balances are included within the above balances of cash and balances with central banks. The mandatory minimum reserve requirement is calculated from defined balance sheet items and has to be fulfilled in average through an extended period of time. Therefore, the mandatory minimum reserve requirement deposits are not subject to any restraints.

14) Derivatives – held for trading

	2017.01.01			2017.12.31			2018		
in HUF million	Notional value	Positive fair value	Negative fair value	Notional value	Positive fair value	Negative fair value	Notional value	Positive fair value	Negative fair value
Derivatives held in the trading book	**2,891,613**	**10,603**	**10,318**	**5,996,537**	**17,856**	**14,692**	**6,187,439**	**21,022**	**18,218**
Interest rate	873,949	4,969	4,037	1,196,809	11,763	4,941	1,015,767	7,973	5,536
Foreign exchange	2,017,664	5,634	6,281	4,799,728	6,093	9,751	5,171,672	13,049	12,681
Derivatives held in the banking book	**1,160,674**	**4,768**	**1,272**	**953,796**	**3,170**	**1,114**	**937,742**	**4,908**	**1,622**
Interest rate	605,547	3,068	375	599,264	2,394	990	811,993	4,908	1,488
Foreign exchange	555,128	1,700	897	354,532	777	124	125,749	-	134
Total gross amounts	**4,052,288**	**15,371**	**11,590**	**6,950,333**	**21,026**	**15,807**	**7,125,181**	**25,930**	**19,839**
Total	**4,052,288**	**15,371**	**11,590**	**6,950,333**	**21,026**	**15,807**	**7,125,181**	**25,930**	**19,839**

15) Other financial assets held for trading

in HUF million	2017.01.01	2017.12.31	2018
Debt securities	101,360	52,042	65,201
General governments	101,159	20,942	36,207
Credit institutions	201	31,100	28,994
Other financial assets held for trading	**101,360**	**52,042**	**65,201**

16) Non-trading financial assets at fair value through profit or loss

	2017		2018	
in HUF million	**Designated**	**Mandatorily**	**Designated**	**Mandatorily**
Equity instruments	x	x	-	1,138
Debt securities	x	x	30,702	-
General governments			30,702	-
Loans and advances to customers	x	x	-	41,732
General governments			-	78
Non-financial corporations			-	668
Households			-	40,986
Financial assets designated and mandatorily at FVPL	x	x	30,702	42,870
Non-trading financial assets at fair value through profit or loss	**x**	**x**		**73,572**

Under 'Loans and advances to customers' contain retail loans having non SPPI characteristics, also see in SPPI assessment chapter page 41. Debt securities contain government bonds.

17) Financial assets - available for sale

in HUF million	2017.01.01	2017.12.31	2018
Equity instruments	2,820	2,159	
Debt securities	134,929	127,357	
General governments	110,356	107,650	
Other financial corporations	24,573	19,708	
Financial assets - available for sale	**137,749**	**129,516**	**x**

18) Financial assets at fair value through other comprehensive income

Equity instruments

The carrying amount of Erste Bank's equity instrument at FVOCI (fair value through other comprehensive income) as at 31 December 2018 amounts to HUF 1,483 million and the full amount is the fair value of shares in Visa Inc. In 2018 Erste Bank recognised a dividend income from Visa Inc. in the amount of HUF 18 million.

During the year 2018 neither selling nor purchasing activities of such instruments happened.

Debt instruments

Gross carrying amounts and credit loss allowances per impairment buckets

	Gross carrying amount				Credit loss allowances					
in HUF million	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Accumulated fair value changes	Fair value
2018										
Debt securities	**134,035**	**-**	**-**	**134,035**	**(26)**	**-**	**-**	**(26)**	**1,534**	**135,569**
General governments	123,965	-	-	123,965	(18)	-	-	(18)	1,482	125,447
Credit institutions	10,070	-	-	10,070	(8)	-	-	(8)	52	10,122
Total	**134,035**	**-**	**-**	**134,035**	**(26)**	**-**	**-**	**(26)**	**1,534**	**135,569**

There are no purchased or originated credit-impaired (POCI) debt securities at FVOCI as of 31 December 2018.

Movement in credit loss allowances

in HUF million	2018.01.01	Additions	Derecognitions	Transfers between stages	Other changes in credit risk (net)	Other	2018.12.31
Stage 1	(19)	(17)	6	-	5	-	(26)
Total	**(19)**	**(17)**	**6**	**-**	**5**	**-**	**(26)**

In the column 'Additions' increases of CLA due to the initial recognition of debt securities at FVOCI during the current reporting period are disclosed. Releases of CLA following the derecognition of the related debt securities at FVOCI are reported in column 'Derecognitions'. In the column 'Transfers between stages' CLA net changes due to changes in credit risk that triggered re-assignments of the related FVOCI debt securities from Stage 1 at 1 January 2018 (or initial recognition date, if later) to Stages 2 or 3 at 31 December 2018 or vice-versa are reported. The effects of transfers from Stage 1 to Stages 2 or 3 on the related CLAs are adverse (incremental year-on-year allocations) and presented in lines attributable to Stages 2 or 3. The effects of transfers from Stages 2 or 3 to Stage 1 on the related CLAs are favourable (incremental year-on-year releases) and presented in the line 'Stage 1'. The P&L-neutral effect from cross-stage transferring of the related CLA amounts recognised prior to stage re-assignments are presented above in the column 'Other changes in credit risk (net)'. Any other changes in credit risk which do not trigger a transfer between Stage 1 and Stage 2 or 3 or vice-versa are disclosed in column 'Other changes in credit risk (net)'.

19) Financial assets – held to maturity

	Gross carrying amount			Collective allowances			Net carrying amount		
in HUF million	2017.01.01	2017.12.31	2018	2017.01.01	2017.12.31	2018	2017.01.01	2017.12.31	2018
General governments	395,338	511,915		-	-		395,338	511,915	
Credit institutions	-	63,525		-	-		-	63,525	
Total	**395,338**	**575,440**	**x**	**-**	**-**	**x**	**395,338**	**575,440**	**x**

20) Securities

	2017.01.01				2017.12.31				2018				
		Financial assets				Financial assets					Financial assets		
in HUF million	Loans and receivables to customers and credit institutions*	Other trading assets	Available for sale	Held to maturity	Loans and receivables to customers and credit institutions*	Other trading assets	Available for sale	Held to maturity	At AC	Trading assets	Mandatorily at FVPL	Designated at FVPL	At FVOCI
Bonds and other interest-bearing securities	**3,959**	**101,360**	**134,929**	**395,338**	**3,288**	**52,042**	**127,357**	**575,440**	**657,981**	**65,201**	**-**	**30,702**	**135,569**
Listed	-	100,012	110,356	378,019	-	48,540	107,650	527,693	625,072	64,340	-	30,702	135,569
Unlisted	3,959	1,348	24,573	17,319	3,288	3,502	19,708	47,747	32,909	861	-	-	-
Equity-related securities	**-**	**-**	**2,041**	**-**	**-**	**-**	**1,331**	**-**	**x**	**-**	**1,138**	**x**	**1,483**
Listed	-	-	-	-	-	-	-	-	x	-	-	x	-
Unlisted	-	-	2,041	-	-	-	1,331	-	x	-	1,138	x	1,483
Equity holdings	**-**	**-**	779	**-**	**-**	**-**	**828**	**-**	**x**	**x**	**x**	**x**	**x**
Total	**3,959**	**101,360**	**137,749**	**395,338**	**3,288**	**52,042**	**129,516**	**575,440**	**657,981**	**65,201**	**1,138**	**30,702**	**137,052**

21) Loans and receivables to credit institutions

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
2017				
Loans and receivables	61,242	-	-	61,242
Central banks	28,985	-	-	28,985
Credit institutions	32,257	-	-	32,257
Total	**61,242**	**-**	**-**	**61,242**

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
2016				
Loans and receivables	145,875	-	-	145,875
Central banks	76,579	-	-	76,579
Credit institutions	69,296	-	-	69,296
Total	**145,875**	**-**	**-**	**145,875**

22) 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	3,506	-	(218)	3,288
General governments	2,337	-	(30)	2,307
Non-financial corporations	1,169	-	(188)	981
Loans and advances to customers	1,233,527	(38,083)	(19,201)	1,176,243
General governments	9,221	-	(9)	9,212
Other financial corporations	84,603	(15)	(180)	84,408
Non-financial corporations	465,743	(4,625)	(9,679)	451,439
Households	673,960	(33,443)	(9,333)	631,184
Total	**1,237,033**	**(38,083)**	**(19,419)**	**1,179,531**

in HUF million	Gross carrying amount	Specific allowances	Collective allowances	Net carrying amount
2016				
Debt securities with customers	4,225	-	(266)	3,959
General governments	2,818	-	(82)	2,736
Non-financial corporations	1,407	-	(184)	1,223
Loans and advances to customers	1,099,947	(62,165)	(15,979)	1,021,803
General governments	540	-	(4)	536
Other financial corporations	69,268	- 8	(126)	69,134
Non-financial corporations	384,029	- 21,351	(8,503)	354,175
Households	646,110	- 40,806	(7,346)	597,958
Total	**1,104,172**	**(62,165)**	**(16,245)**	**1,025,762**

Allowances for loans and receivables to customers

in HUF million	01.01.2017	Allocations	Use	Releases	Interest income from impaired loans	Exchange-rate and other changes	31.12.2017	Amounts written off	Recoveries of amounts previously written off
Specific allowances	**(62,165)**	**(15,168)**	**13,960**	**23,470**	**1,680**	**141**	**(38,083)**	**(11,703)**	**5,433**
Debt securities with customers	-	-	-	-	-	-	-	-	-
Loans and advances to customers	(62,165)	(15,168)	13,960	23,470	1,680	141	(38,083)	(11,703)	5,433
Other financial corporations	(8)	(15)	-	8	-	-	(15)	(3)	4
Non-financial corporations	(21,351)	(2,582)	7,366	11,742	115	84	(4,626)	(11,684)	1,538
Households	(40,806)	(12,571)	6,594	11,719	1,565	57	(33,442)	(16)	3,891
Collective allowances	**(16,245)**	**(12,698)**	-	**9,445**	-	**79**	**(19,419)**	-	-
Debt securities with customers	(266)	(33)	-	61	-	20	(218)	-	-
General governments	(82)	-	-	46	-	6	(30)	-	-
Non-financial corporations	(184)	(33)	-	15	-	14	(188)	-	-
Loans and advances to customers	(15,979)	(12,665)	-	9,384	-	59	(19,201)	-	-
General governments	(4)	(5)	-	4	-	(4)	(9)	-	-
Other financial corporations	(126)	(115)	-	56	-	5	(180)	-	-
Non-financial corporations	(8,503)	(5,903)	-	4,670	-	57	(9,679)	-	-
Households	(7,346)	(6,642)	-	4,654	-	1	(9,333)	-	-
Total	**(78,410)**	**(27,866)**	**13,960**	**32,915**	**1,680**	**220**	**(57,502)**	**(11,703)**	**5,433**

23) Financial assets at amortised cost

Gross carrying amounts and credit loss allowances per impairment buckets

Debt securities at amortised cost

	GCA				CLA				
in HUF million	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Carrying amount
2018									
General governments	625,133	-	-	625,133	(92)	-	-	(92)	625,041
Credit institutions	32,474	-	-	32,474	(18)	-	-	(18)	32,456
Non-financial corporations	27	-	1,083	1,110	-	-	(626)	(626)	484
Total	**657,634**	-	**1,083**	**658,717**	**(110)**	-	**(626)**	**(736)**	**657,981**

There are no purchased or originated credit-impaired (POCI) debt securities at AC as of 31 December 2018.

Movement in credit loss allowances

in HUF million	As of	Additions	Derecognitions	Transfers between Stage 1 and 2/3(+/-)	Other changes in credit risk (net)	Other	As of
	01 January 2018						31 December 2018
Stage 1	(117)	(40)	29	-	18	-	(110)
Stage 2	(287)	-	113	-	175	-	1
Stage 3	-	-	-	-	(583)	(44)	(627)
Total	**(404)**	**(40)**	**142**	**-**	**(390)**	**(44)**	**(736)**

In the column 'Additions' increases of CLA due to the initial recognition of debt securities at AC during the current reporting period are disclosed. Releases of CLA following the derecognition of the related debt securities at AC are reported in column 'Derecognitions'. In the column 'Transfers between stages' CLA net changes due to changes in credit risk that triggered re-assignments of the related AC debt securities from Stage 1 at 1 January 2018 (or initial recognition date, if later) to Stages 2 or 3 at 31 December 2018 or vice-versa are reported. The effects of transfers from Stage 1 to Stages 2 or 3 on the related CLAs are adverse (incremental year-on-year allocations) and presented in lines attributable to Stages 2 or 3. The effects of transfers from Stages 2 or 3 to Stage 1 on the related CLAs are favourable (incremental year-on-year releases) and presented in the line 'Stage 1'. The P&L-neutral effect from cross-stage transferring of the related CLA amounts recognised prior to stage re-assignments are presented above in the column 'Other changes in credit risk (net)'. Any other changes in credit risk which do not trigger a transfer between Stage 1 and Stage 2 or 3 or vice-versa are disclosed in column 'Other changes in credit risk (net)'.

One significant driver of the CLA movements for the year has been the transfer of the related instruments across different stages. The year-end GCAs of AC debt securities that were assigned at 31 December 2018 to a different stage compared to 1 January 2018 (or to the initial recognition date, if originated during the year) are summarised in the table below:

in HUF million	2018
Transfers between Stage 2 and Stage 3	**1,083**
To Stage 3 from Stage 2	1,083

The year-end total GCAs of AC debt securities that were initially recognised (purchased) during the year 2018 and not sold by 31 December 2018 amounts to approximately 233 billion forint. The GCA of AC debt securities that were held at 1 January 2018 and de-recognised (matured or sold compliant to sale from HTC business model) during the year 2018 amounts to 184 billion forint.

24) Loans and advances to banks at amortised cost

	GCA				CLA				
in HUF million	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	Carrying amount
2018									
Central banks	23,489	-	-	23,489	(2)	-	-	(2)	23,487
Credit institutions	72,203	-	-	72,203	(60)	-	-	(60)	72,143
Total	**95,692**	**-**	**-**	**95,692**	**(62)**	**-**	**-**	**(62)**	95,630

There are no purchased or originated credit-impaired (POCI) AC loans and advances to banks at 31 December 2018.

Movement in credit loss allowances

in HUF million	As of	Additions	Derecognitions	Other changes in credit risk (net)	Other	As of
	01 January 2018					31 December 2018
Stage 1	(27)	(39)	32	(30)	2	(62)
Stage 2	-	-	4	(4)	-	-
Stage 3	-	-	114	(239)	125	-
Total	**(27)**	**(39)**	**150**	**(273)**	**127**	**(62)**

In the column 'Additions' increases of CLA due to the initial recognition of loans and advances to banks at AC during the current reporting period are disclosed. Releases of CLA following the derecognition of the related loans and advances to banks at AC are reported in column 'Derecognitions'. In the column 'Transfers between stages' CLA net changes due to changes in credit risk that triggered re-assignments of the related AC loans and advances to banks from Stage 1 at 1 January 2018 (or initial recognition date, if later) to Stages 2 or 3 at 31 December 2018 or vice-versa are reported. The effects of transfers from Stage 1 to Stages 2 or 3 on the related CLAs are adverse (incremental year-on-year allocations) and presented in lines attributable to Stages 2 or 3. The effects of transfers from Stages 2 or 3 to Stage 1 on the related CLAs are favourable (incremental year-on-year releases) and presented in the line 'Stage 1'. The P&L-neutral effect from cross-stage transferring of the related CLA amounts recognised prior to stage re-assignments are presented above in the column 'Other changes in credit risk (net)'. Any other changes in credit risk which do not trigger a transfer between Stage 1 and Stage 2 or 3 or vice-versa are disclosed in column 'Other changes in credit risk (net)'.

The year-end total GCA of AC loans and advances to banks that were initially recognised during the year 2018 and not fully de-recognised by 31 December 2018 amounts to 95 billion forint. The GCA of AC loans and advances to banks that were held as of 1 January 2018 and fully de-recognised during the year 2018 amounts to 62 billion forint.

25) Loans and advances to customers at amortised cost

Gross carrying amounts and credit loss allowances per impairment buckets

	GCA					CLA					
in HUF million	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	Carrying amount
As of 31 December 2018											
General governments	14,597	-	-	-	14,597	(1)	-	-	-	(1)	**14,596**
Other financial corporations	69,303	1	-	11	69,315	(151)	-	-	-	(151)	**69,164**
Non-financial corporations	476,176	8,245	2,841	12,206	499,468	(1,396)	(485)	(2,187)	(544)	(4,612)	**494,856**
Households	591,664	29,356	22,495	25,839	669,354	(3,017)	(4,596)	(17,005)	(10,509)	(35,127)	**634,227**
Total	**1,151,740**	**37,602**	**25,336**	**38,056**	**1,252,734**	**(4,565)**	**(5,081)**	**(19,192)**	**(11,053)**	**(39,891)**	**1,212,843**

.

in HUF million	As of	Additions	Derecognitions	Transfers between stages	Other changes in credit risk (net)	Insignificant modifications (net)	Write-offs	Other	As of
	01 January 2018								31 December 2018
Stage 1	**(4,774)**	**(1,286)**	**809**	**679**	**-**	**(6)**	**37**	**(24)**	**(4,565)**
General governments	(2)	(1)	2	-	-	-	-	-	(1)
Other financial corporations	(220)	(95)	158	9	-	-	-	(2)	(150)
Non-financial corporations	(1,347)	(359)	325	5	-	-	1	(22)	(1,397)
Households	(3,205)	(831)	324	665	-	(6)	36	-	(3,017)
Stage 2	**(6,829)**	**(544)**	**1,099**	**(1,535)**	**866**	**(19)**	**1,895**	**(14)**	**(5,081)**
Non-financial corporations	(2,162)	(54)	820	-	866	-	55	(9)	(484)
Households	(4,667)	(490)	279	(1,535)	-	(19)	1,840	(5)	(4,597)
Stage 3	**(22,609)**	**(671)**	**4,112**	**(623)**	**9**	**(170)**	**786**	**(26)**	**(19,192)**
Other financial corporations	(9)	-	-	-	9	-	-	-	-
Non-financial corporations	(2,696)	(157)	1,183	(533)	-	-	38	(21)	(2,186)
Households	(19,904)	(514)	2,929	(90)	-	(170)	748	(5)	(17,006)
POCI	**(17,044)**	**-**	**2,127**	**-**	**3,576**	**(71)**	**371**	**(12)**	**(11,053)**
Non-financial corporations	(2,677)	-	381	-	1,760	-	2	(11)	(545)
Households	(14,367)	-	1,746	-	1,816	(71)	369	(1)	(10,508)
Total	**(51,256)**	**(2,501)**	**8,147**	**(1,479)**	**4,451**	**(266)**	**3,089**	**(76)**	**(39,891)**

In category POCI Erste Bank doesn't recognize purchased credit impaired instruments, but presents instrument subject to derecognition and recognition as new instruments. These instruments are typically subject to contractual changes bearing characteristics with de-recognition criteria like change in currency of the contract.

In the column 'Additions' increases of CLA due to the initial recognition of loans and advances to customers at AC during the current reporting period are disclosed. Releases of CLA following the derecognition of the related loans and advances to customers at AC are reported in column 'Derecognitions'. In the column 'Transfers between stages' CLA net changes due to changes in credit risk that triggered re-assignments of the related AC loans and advances to customers from Stage 1 at 1 January 2018 (or initial recognition date, if later) to Stages 2 or 3 at 31 December 2018 or vice-versa are reported. The effects of transfers from Stage 1 to Stages 2 or 3 on the related CLAs are adverse (incremental year-on-year allocations) and presented in lines attributable to Stages 2 or 3. The effects of transfers from Stages 2 or 3 to Stage 1 on the related CLAs are favourable (incremental year-on-year releases) and presented in the line 'Stage 1'. The P&L-neutral effect from cross-stage transferring of the related CLA amounts recognised prior to stage re-assignments are presented above in the column 'Other changes in credit risk (net)'. Any other changes in credit risk which do not trigger a transfer between Stage 1 and Stage 2 or 3 or vice-versa are disclosed in column 'Other changes in credit risk (net)'. This column also captures the passage-of-time adverse effect ('unwinding correction') over the lifetime expected cash shortfalls of AC loans and advances to customers that were assigned to Stage 3 for any period throughout the year, as well as of any POCI loans and advances to customers. The unwinding correction accumulated during the reporting period amounted to 1 621 million Forint in case of debt instruments at amortised cost.

This adverse effect amounted to 3,694 million forint cumulatively for the year 2018, which also reflects the unrecognised interest income out of the related AC loans and advances to customers throughout the year. The column 'Insignificant modifications (net)' reflects the effect on CLA arising from contractual modifications of loans and advances to customers at AC which do not trigger their full derecognition. The use of CLA triggered by full or partial write-offs of AC loans and advances to customers is reported in columns 'Write-offs'.

In general impairment release was the consequence of the portfolio quality improvement of the loan portfolio and the low level of loans with significant increase of credit risk (stage2). The defaults rate of the loan portfolio is decreasing continuously reaching a record low level

.

in both corporate and retail segment and further improvement is expected due to the strict lending criteria. Improved portfolio quality also means, that the existing loan portfolio bears no significant increase of credit risk.

The reduction of the existing non-performing exposure is still one of the main focus of the Risk area. Workout activity includes cooperative strategies as well as debt-sale and write-offs. The Retail provision volume decreased mainly as a result of the better than expected recoveries from the cleaning of the existing NPL portfolio. On the Corporate side, the Real Estate segment was the main driver as the upgrade of big ticket size clients caused 4.0 billion forint risk cost release. Overall portfolio quality improvement also resulted a low level of new default keeping the impairment creation lower than the releases.

One significant driver of the CLA movements for the year has been the transfer of the related instruments across different impairment stages. The year-end GCA of AC loans and advances to customers that were assigned at 31 December 2018 to a different stage compared to 1 January 2018 (or to the initial recognition date, if originated during the year) are summarised below:

	Transfers between Stage 1 and Stage 2		Transfers between Stage 2 and Stage 3		Transfers between Stage 1 and Stage 3		POCI	
in HUF million	To Stage 2 from Stage 1	To Stage 1 from Stage 2	To Stage 3 from Stage 2	To Stage 2 from Stage 3	To Stage 3 from Stage 1	To Stage 1 from Stage 3	To Defaulted from Non-Defaulted	To Non-Defaulted from Defaulted
Other financial corporations	-	-	-	-	-	9	-	11
Non-financial corporations	4,099	2,637	483	1	1,218	3	72	1
Households	22,076	7,133	1,600	932	4,296	2,086	308	2,767
Total	**26,175**	**9,770**	**2,083**	**933**	**5,514**	**2,098**	**380**	**2,779**

The year-end total GCA of the AC loans and advances to customers that were initially recognised during the year 2018 and not fully de-recognised by 31 December 2018 amounts to 347 billion forint. The GCA of the AC loans and advances to customers that were held at 1 January 2018 and fully de-recognised during the year 2018 amounts to 280 billion.
The undiscounted amount of the lifetime expected credit losses considered in the initial measurement of the AC loans and advances to customers initially recognised and identified as POCI during the year 2018 amounted to 3,576 million forint.

26) Finance lease receivables

Gross carrying amounts and credit loss allowances per impairment buckets

	GCA					CLA					
in HUF million	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	Carrying amount
2018											
Other financial corporations	35	1	-	-	**36**	-	-	-	-	**-**	**36**
Non-financial corporations	33,363	787	94	41	**34,285**	(116)	(34)	(83)	(8)	**(241)**	**34,044**
Households	3,247	185	316	81	**3,829**	(14)	(23)	(231)	(39)	**(307)**	**3,522**
Total	**36,645**	**973**	**410**	**122**	**38,150**	**(130)**	**(57)**	**(314)**	**(47)**	**(548)**	**37,602**

.

Movement in credit loss allowances

in HUF million	As of	Additions	Transfers between stages	Other changes in credit risk (net)	Write-offs	Other	As of
	01 January 2018						31 December 2018
Stage 1	(114)	(34)	5	4	-	8	(131)
Stage 2	(76)	(11)	-	25	-	6	(56)
Stage 3	(394)	-	(2)	47	9	26	(314)
POCI	(231)	-	-	184	-	-	(47)
Total	**(815)**	**(45)**	**3**	**260**	**9**	**40**	**(548)**

In the column 'Additions' increases of CLA due to the initial recognition of finance lease receivables during the current reporting period are disclosed. Releases of CLA following the derecognition of the related finance lease receivables are reported in column 'Derecognitions'. In the column 'Transfers between stages' CLA net changes due to changes in credit risk that triggered re-assignments of the related finance lease receivables from Stage 1 as of 1 January 2018 (or initial recognition date, if later) to Stages 2 or 3 as of 31 December 2018 or vice-versa are reported. The effects of transfers from Stage 1 to Stages 2 or 3 on the related CLAs are adverse (incremental year-on-year allocations) and presented in lines attributable to Stages 2 or 3. The effects of transfers from Stages 2 or 3 to Stage 1 on the related CLAs are favourable (incremental year-on-year releases) and presented in the line 'Stage 1'. The P&L-neutral effect from cross-stage transferring of the related CLA amounts recognised prior to stage re-assignments are presented above in the column 'Other changes in credit risk (net)'. Any other changes in credit risk which do not trigger a transfer between Stage 1 and Stage 2 or 3 or vice-versa are disclosed in column 'Other changes in credit risk (net)'. This column also captures the passage-of-time adverse effect ('unwinding correction') over the lifetime expected cash shortfalls of finance lease receivables that were assigned to Stage 3 for any period throughout the year, as well as of any POCI finance lease receivables. The column 'Insignificant modifications (net)' reflects the effect on CLA arising from contractual modifications of finance lease receivables which do not trigger their full derecognition. The use of CLA triggered by full or partial write-offs of finance lease receivables is reported in columns 'Write-offs'.

One significant driver of the CLA movements for the year has been the transfer of the related instruments across impairment stages. The year-end GCA of finance lease receivables that were assigned at 31 December 2018 to a different stage compared to 1 January 2018 (or to the initial recognition date, if originated during the year) are summarised below:

in HUF million	2018
Transfers between Stage 1 and Stage 2	
To Stage 2 from Stage 1	802
To Stage 1 from Stage 2	275
Transfers between Stage 2 and Stage 3	
To Stage 3 from Stage 2	20
To Stage 2 from Stage 3	17
Transfers between Stage 1 and Stage 3	
To Stage 3 from Stage 1	57
To Stage 1 from Stage 3	93
POCI transfer	
To non-defaulted from defaulted	5

.

27) Trade and other receivables

Gross carrying amounts and credit loss allowances per impairment buckets

	Gross carrying amount					Credit loss allowances					
in HUF million	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	Carrying amount
2018											
Central banks	-	-	-	-	-	-	-	-	-	-	-
General governments	719	-	-	-	719	-	-	-	-	-	719
Credit institutions	1	-	-	-	1	-	-	-	-	-	1
Other financial corporations	2,104	-	-	-	2,104	-	-	-	-	-	2,104
Non-financial corporations	11,297	46	-	-	11,343	(56)	(1)	-	-	(57)	11,285
Households	3	-	-	-	3	-	-	-	-	-	3
Total	**14,125**	**46**	**-**	**-**	**14,171**	**(57)**	**(1)**	**-**	**-**	**(58)**	**14,113**

Movement in credit loss allowances

in HUF million	2018.01.01	Additions	Derecognitions	Transfers between stages	Other changes in credit risk (net)	Other	2018.12.31
Stage 1	(59)	(65)	106	2	(41)	-	(56)
Stage 2	-	(1)	1	(1)	-	-	(1)
Total	**(59)**	**(66)**	**106**	**1**	**(40)**	**-**	**(58)**

28) Debt instrument subject to contractual modifications

As at 31 December 2018, the total GCA of Erste Bank's debt instruments measured at AC, which were impacted by non-significant contractual modifications amounted to HUF 4,031 million. The total GCA of debt instruments measured at AC which were assigned to Stage 2 or 3 and re-assigned to Stage 1 during the year 2018 amounted to HUF 653 million.

Impact of contractual modifications in profit or loss

in HUF million	Amortised cost before the modification	Net modification gains/losses
Loans and advances	**4 031**	**381**
Households	4 031	381
Total	**4 031**	**381**

29) 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)	Total
Value 01.01.2018	**41,192**	**9,359**	**9,470**	**4,906**	**10,399**	**75,326**
Additions	7,485	-	630	129	1,661	9,905
Disposals	(1,726)	(427)	(33)	(356)	(1,380)	(3,922)
Reclassification	(1)	298	(298)	-	1	-
Value 31.12.2018	**46,950**	**9,230**	**9,769**	**4,679**	**10,681**	**81,309**

DEPRECIATION AND IMPAIRMENT in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings[1)]	Office and plant equipment/other fixed assets	IT-assets (hardware)	Total
Value 01.01.2018	**26,028**	**2,208**	**4,417**	**3,871**	**8,147**	**44,671**
Additions	6,074	1,274	914	336	1,114	9,712
Disposals	(1,726)	(426)	(18)	(302)	(1,379)	(3,851)
Reclassification	(1)	293	(293)	-	1	-
Impairment	1,303	-	-	-	-	1,303
Value 31.12.2018	**31,678**	**3,349**	**5,020**	**3,905**	**7,883**	**51,835**

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)	Total
Value 01.01.2018	**15,164**	**7,151**	**5,053**	**1,035**	**2,252**	**30,655**
Value 31.12.2018	**15,272**	**5,881**	**4,749**	**774**	**2,798**	**29,474**

1) The depreciation relates to buildings within ‚Own land and buildings‘.

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)	Total
Value 01.01.2017	**37,884**	**1,467**	**9,616**	**5,280**	**9,617**	**63,864**
Additions	5,304	7,894	527	381	1,266	15,372
Disposals	(2,005)	(2)	(673)	(755)	(475)	(3,910)
Reclassification	9	-	-	-	(9)	-
Value 31.12.2017	**41,192**	**9,359**	**9,470**	**4,906**	**10,399**	**75,326**

DEPRECIATION AND IMPAIRMENT in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings[1)]	Office and plant equipment/other fixed assets	IT-assets (hardware)	Total
Value 01.01.2017	**22,645**	**1,040**	**4,072**	**4,126**	**7,658**	**39,541**
Additions	5,147	1,170	750	421	960	8,448
Disposals	(2,005)	(2)	(405)	(676)	(471)	(3,559)
Impairment	241	-	-	-	-	241
Value 31.12.2017	**26,028**	**2,208**	**4,417**	**3,871**	**8,147**	**44,671**

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)	Total
Value 01.01.2017	**15,239**	**427**	**5,544**	**1,154**	**1,959**	**24,323**
Value 31.12.2017	**15,164**	**7,151**	**5,053**	**1,035**	**2,252**	**30,655**

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

in HUF million	2017	2018
Intangible assets	**22,315**	**21,153**
Software acquired	15,164	15,272
Other intangible assets (licenses, patents, customer lists etc.)	7,151	5,881
Property and equipment	**8,340**	**8,321**
Own land and buildings	5,053	4,749
Office and plant equipment/other fixed assets	1,035	774
IT-assets (hardware)	2,252	2,798
Total intangible and tangible assets	**30,655**	**29,474**

Within fully amortised intangible assets still in use, Erste Bank Hungary has recognised software with a gross value amounting to 5,726 million forint in 2018 and 4,948 million forint in 2017.

30) Tax assets and liabilities

Major components of deferred tax assets and deferred tax liabilities

	Tax assets		Tax liabilities		Net variance 2018		
in HUF million	2017	2018	2017	2018	Total	through profit or loss	through other comprehensive income
Deferred taxes	**-**	**3,321**	**(564)**	**-**	**3,885**	**3,562**	**709**
Temporary differences related to the following items:			-	-	-		
Trading Assets / Liabilities and Designation at fair value through Profit or Loss	1	-	155	-	(156)	156	-
Financial assets at fair value through other comprehensive income	47	-	-	192	145	-	145
Financial assets at amortised cost & trade & other receivables	2,527	-	-	-	(2,527)	(2,527)	-
Financial assets - available for sale	-	-	(564)	-	564	-	564
Property and equipment (useful life in tax law different)	34	82	-	-	48	48	-
Amortisation of investments in subsidiaries (tax-effective in subsequent years)	-	-	422	-	(422)	421	-
Financial liabilities measured at amortised cost (deposits and debt securities issued)	-	-	24	-	(24)	24	-
Other provisions (tax valuation different)	375	11	-	-	(364)	(364)	-
Tax loss carry-forward	-	1,839	-	-	1,839	1,839	-
Other	221	1,581	16	-	1,344	1,377	-
Impairment	(2,588)	-	-	-	2,588	2,588	-
Effect of netting gross deferred tax position	(617)	(192)	(617)	(192)	850	-	-
Current taxes	**628**	**1,380**	**-**	**-**	**(5,064)**	**(5,064)**	**1,380**
Total taxes	**628**	**4,701**	**(564)**	**-**	**(1,179)**	**(1,502)**	**2,089**

	Tax assets		Tax liabilities		Net variance 2017		
in HUF million	2017.01.01	2017.12.31	2017.01.01	2017.12.31	Total	through profit or loss	through other comprehensive income
Deferred taxes	**-**	**-**	**(238)**	**(564)**	**(326)**	**14**	**(340)**
Financial assets – held for trading	-	-	(164)	-	**164**	**164**	
Financial assets - available for sale	-	-	(256)	(596)	(340)	-	(340)
Financial assets - held to maturity	-	-	195	72	(123)	(123)	-
Financial liabilities measured at amortised cost	-	-	-	(24)	(24)	(24)	-
Provisions	-	-	(50)	-	50	50	-
Other	-	-	37	(16)	(53)	(53)	-
Current taxes	**636**	**628**	**-**	**-**	**(9)**		
Total taxes	**636**	**628**	**(238)**	**(564)**	**(335)**	**14**	**(340)**

Erste Bank Hungary allocated 3.3 billion forint deferred tax asset as of 31 December 2018, having the breakdown as follows:

- 1.5 billion forint is in relation with the positive transitional difference to be used in equal instalment in the coming two tax years (first third was used in the 2018 tax year, no more subject to deferred tax asset allocation), due to the fact that credit institutions are obliged to transfer as of 1 January 2018 from local accounting standard (HAS) to IFRS adopted by EU.
- 1.8 billion forint is allocated in accordance with IAS12 saying a deferred tax asset shall be recognised for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. Taking into consideration that legal act relative to utilization of tax loss carried forward prescribes a 'first in first out' logic, future profitability perspective limits the theoretical tax loss carry forward of 142 billion as of 31 December 2018 to 94 billion forint on consolidated level representing the amount to be used first, expiring 2025 (next lots in the usage ranking expires earlier). Incorporating economic trends, changes in legal environment especially in relation of banking sector covering both the near past events and those in the last five years, Erste Bank Hungary set up profitability scenarios weighting them by probabilities including a haircut starting from 45% converging to 100% on projection time horizon. These scenarios are subject to regular follow-up to identify need for adjustment.

31) Assets held for sale

in million HUF	01 January 2017	31 December 2017	2018
Assets held for sale	-	-	30

In 2018 the investment in Erste Lakáslízing Zrt. has been classified as asset held for sale as described in section B. ACQUISITIONS, MERGERS AND DISPOSALS.

32) Other assets

in HUF million	01.01.2017	31.12.2017	2018
Clearing accounts with tax authorities	-	590	736
Other clearing accounts	2,314	3,101	5,911
Other financial assets	3,489	3,325	4,012
Other accrued income	2,412	2,770	3,146
Inventories	298	407	120
Repossessed assets[1)]	340	99	63
Prepaid expenses	4,394	1,739	1,919
Other	2,483	6,150	7,315
Total	**15,730**	**18,181**	**23,222**

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 Bank Hungary's policy is to dispose of them in an orderly fashion. Erste Bank Hungary does not occupy repossessed assets for its own business use.
The amount of the impairment of the repossessed assets is 0.3 million forint (in 2017: 46 million forint).

2) Other financial assets balance contains customer receivables.

33) Financial liabilities at amortised costs

Deposits from banks

in HUF million	2017.01.01	2017.12.31	2018
Deposit from domestic banks	186,024	219,660	330,770
Deposit from foreign banks	93,988	60,002	60,869
of which by Austrian banks	83,346	58,721	57,593
of which subordinated liabilities	50,805	50,666	52,512
Total	**280,012**	**279,662**	**391,639**

Deposits from banks - subordinated liabilities

Maturity	Notional amount 2017.01.01		Notional amount 2017.12.31		Notional amount 2018		Interest conditions
	in thousand EUR	in million HUF	in thousand EUR	in million HUF	in thousand EUR	in million HUF	
01 March 2024	100,000	31,101	100,000	31,014	100,000	32,151	3M EURIBOR + 3,92%, quarterly*
01 March 2024	28,312	8,806	28,312	8,781	28,312	11,253	3M EURIBOR+ 4,11%, quarterly*
01 March 2024	35,000	10,886	35,000	10,855	35,000	9,102	3M EURIBOR+ 3,83%, quarterly*
Total subordinated loans	**163,312**	**50,793**	**163,312**	**50,650**	**163,312**	**52,506**	

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	2017.01.01	2017.12.31	2018
Saving deposits	2,360	2,356	2,352
Other deposits	1,387,155	1,476,761	1,646,879
Public sector	24,217	52,211	35,059
Commercial customers	446,086	453,421	473,752
Private customers	520,544	695,551	820,689
Other financial institutions	396,308	275,578	317,379
Total	**1,389,515**	**1,479,116**	**1,649,231**

Debt securities issued

in HUF million	2017.01.01	Notional amount 2017.01.01	2017.12.31	Notional amount 2017.12.31	2018	Notional amount 2018
Bonds	15,114	15,194	6,052	6,247	7,647	4,226
of which subordinated liabilities	3,779	4,215	4,043	4,215	4,307	4,215
Certificate of deposits	790	790	784	784	824	824
Total	**15,904**	**15,984**	**6,836**	**7,031**	**8,471**	**5,051**

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 2018	ISIN code	Date of issue	Date of maturity	Notional amount in HUF million	Currency	Interest conditions
Bonds						
ERSTE USD KÖTVÉNY 2.3 2018-2021	HU0000358460	2. October 2018	1 October 2021	3	HUF	fixed 2,30% interest payments: yearly
ERSTE USD KÖTVÉNY II 2.3 2018-2021	HU0000358510	5 November 2018	4 November 2021	2	HUF	fixed 2,30% interest payments: yearly
ERSTE USD KÖTVÉNY 2.40 2018-2021	HU0000358536	4 December 2018	3 December 2021.	4	HUF	fixed 2,40% interest payments: yearly
ERSTE USD KÖTVÉNY 2.00 2018-2019	HU0000358544	4 December 2018	4 December 2019	3	HUF	fixed 2,00% interest payments: yearly
Total				**12**		
certificate of deposit	AT2222222222	1 January 1990	25 November 2017	824	HUF	
Total				**824**		

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	17 November 2015	16 November 2018	161	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180817	HU0000356522	19 August 2015	17 August 2018	599	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20181008	HU0000356605	7 October 2015	8 October 2018	647	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180102	HU0000356423	24 June 2015	2 January 2018	625	HUF	zero coupon
Total				**2,033**		
certificate of deposit	AT2222222222	1 January 1990	25 November 2016	784	HUF	
Total				**784**		

Debt securities issued - subordinated liabilities

As of 31 December 2018

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 2017

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**			

34) Provisions

in HUF million	01 January 2017	31 December 2017	2018
Pending legal issues and tax litigation	623	2,409	1,602
Loan commitments and financial guarantees given	21,664	3,560	2,510
Provisions for guarantees - off balance sheet (defaulted customers)	20,715	569	x
Provisions for guarantees - off balance sheet (non-defaulted customers)	950	2,991	x
CLA for loan commitments and financial guarantees in Stage 1	-	x	956
CLA for loan commitments and financial guarantees in Stage 2	-	x	181
CLA for loan commitments and financial guarantees - Defaulted	-		1,372
Other provisions	2,796	2,660	3,158
Provisions	**25,083**	**8,629**	**7,270**

Pending legal issues and tax litigations

Provision for pending legal issues and tax litigations covers both allowances for legal cases related to lending activities and such legal cases that have no direct linkage to the core business of the company such as, for example, labour and employment related issues. Erste Bank was not involved in tax litigations neither in 2017, nor in 2018.

This category also includes 0.8 billion forint (1.7 billion forint in 2017) 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 procedure the original decision is nailed, the amount of the fine was paid back to the Bank and new procedure is ordered. Conforming to the decision the Bank allocated legal provision in 2017, in the amount of the original fine of 1.7 billion forint. In the course of the new procedure the Bank needed to pay a fine, but as this decision was also appealed, the residual provision was decided to keep in the books as of 31 December 2018.

Other provisions

Both in 2018 and 2017 the determining majority of other provisions are coming from items already recognised in erlier years, 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.

Provision movement tables

Credit loss allowances for loan commitments and financial guarantees 2018

in HUF million	As of 01 January 2018	Additions	Derecognitions	Transfers between stages	Other changes in credit risk (net)	Other	As of 31 December 2018
Stage 1	1,154	341	(74)	(465)	-	-	956
Stage 2	167	-	(46)	59	-	1	181
Defaulted	1,070	647	(1,323)	1,013	(35)	-	1,372
Total	**2,391**	**988**	**(1,443)**	**607**	**(35)**	**1**	**2,509**

Sundry provisions 2018

in HUF million	As of 01 January 2018	Allocations	Use	Releases	Exchange rate and other changes (+/-)	As of 31 December 2018
Pending legal issues and tax litigation	2,409	1,113	(154)	(1,765)	-	1,603
Commitments and guarantees given out of scope of IFRS9	-	1,162	-	(704)	200	658
Other provisions	2,660	-	(66)	(248)	154	2,500
Provisions for onerous contracts	-	-	-	-	-	-
Other	2,660	-	(66)	(248)	154	2,500
Provisions	**5,069**	**2,275**	**(220)**	**(2,717)**	**354**	**4,761**

Sundry 2017

in HUF million	As of 01 January 2017	Allocations	Use	Releases	Exchange rate changes	As of 31 December 2017
Provision for guarantees	21,664	3,054	-	(21,090)	(68)	3,560
Provision as a precaution	63	2,020	-	(25)	1	2,059
Other sundry provisions	3,356	26,216	(17,098)	(9,005)	(459)	3,010
Total	**25,083**	**31,290**	**(17,098)**	**(30,120)**	**(526)**	**8,629**

35) Other liabilities

in HUF million	01.01.2017	31.12.2017	2018
Deferred income[1)]	4,070	2,240	427
Clearing accounts	12,109	9,731	16,197
Tax liabilities	1,112	1,192	619
Other financial liabilities[2)]	1,909	1,703	1,083
Received payments on advance	55	5	5
Accruals of other expenses	8,986	10,644	10,516
Other liabilities	577	1,701	2,319
Total	**28,818**	**27,216**	**31,166**

1) Erste Bank 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 2018 202 million forint (in 2017: 266 million forint) is presented as government grant related to IRS, the deferred income is 116 million forint (in 2017: 318 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 2018 1,548 million forint (in 2017: 1,548 million forint) is presented as government grant related to HIRS, the deferred income is 144 million forint (in 2017: 1,692 million forint).

Government grant is presented starting from 2017:

At 1 January 2018	2,010 million forint
Received during the year	0 million forint
Released to the income statement	1,750 million forint
At 31 December 2018	260 million forint
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

2) Other financial liabilities balance contains supplier liabilities.

36) Total equity

in HUF million	01.01.2017	31.12.2017	31.12.2018
Subscribed capital	146,000	146,000	146,000
Additional paid-in capital	117,492	117,492	117,492
Retained earnings and other reserves	6,838	62,523	84,832
Total	**270,330**	**326,015**	**348,324**
Attributable to owners of the parent	270,330	326,015	348,324

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, dematerialised 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 2018 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 dematerialised ordinary shares of 1 forint nominal value each.

Owners of the Bank
As of 31 December 2018, 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 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 2017		31 December 2018	
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%**

In the below tables the equity of Erste Bank is presented in two different structures as required by the Hungarian accounting law (Law of 2000: C., 114 / B. §) to ensure the comparability between components of equity in the IFRS and HAS financial statements.

in HUF million	2017	2018
IFRS financial statements		
Subscribed capital	146 000	146 000
Additional paid-in capital	117 492	117 492
General reserve	3 526	11 624
Fair value reserve	5 609	1 965
Retained earnings	53 388	71 243
Total equity	**326 015**	**348 324**
Based on Hungarian accounting law (Law of 2000: C., 114 / B. §)		
Subscribed capital	146 000	146 000
Capital reserve	117 492	117 492
Tied-up reserve	3 526	11 624
Revaluation reserve	5 609	1 965
Retained earnings	945	13 742
Net result for the year	52 443	57 499
Total equity	**326 015**	**348 324**
of which		
Capital subscribed by the Court of Registry	146 000	146 000
Reserve available for dividend payment	53,388	71,243

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. The total amount of the general reserve is 17,373 million forint at the end of 2018 (in 2017: 11,623 million forint). 'Retained earnings and other reserves' also includes 'Retained earnings' of 65,493 million forint and 'Fair value reserve' of 2,158 million forint with related deferred tax of (192) million forint in 2018. In 2017 the amount of 'Retained earnings' was 45,291 million forint and the amount of 'Available for sale reserve' was 6,164 million forint with related deferred tax of (555) million forint.

37) Segment reporting

The Bank's segmental reporting is based on the following operating segments: Retail, Corporates (including Small and Medium Enterprises (SME), Group Markets (including Group Markets Trading (GMT) and Asset/Liability Management & Local Corporate Centre (comprises Assets and Liabilities Management (ALM), Corporate Centre and Free capital).

Erste Bank 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 Bank. 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.

The segment reporting of Erste Bank 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 Bank sells products mainly to private and micro customers (up to 1.0 million euro GDP weighted turnover). The Retail business line at Erste Bank Hungary is divided into 5 regions.

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 centre network, mainly consisting of companies with an annual turnover from EUR 1.0 million to EUR 50 million.

Local Large Corporates (LLC) are clients with specific annual turnover thresholds above EUR 50 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.

Public Sector consists of three sets of customers: public sector, public corporations and non-profit sector. Most of the local governments are in Public Sector as well.

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 Bank Hungary, 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).

Asset/Liability Management & Local Corporate Centre

The Asset/Liability Management & Local Corporate Centre (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. The Corporate Centre includes the reconciliations to the accounting result.

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

Business Segments

	Retail	Corporates	Group Mar-kets	ALM&LCC	TOTAL
in HUF million	**2018**	**2018**	**2018**	**2018**	**2018**
Net interest income	49,294	17,387	2,334	(2,160)	66,855
Net fee and commission income	36,777	8,218	1,895	(998)	45,892
Dividend income	-	-	-	4,337	4,337
Net trading result	3,438	2,831	4,512	2,778	13,559
Gains/losses from financial instruments at FVPL	(386)	5	-	(1,827)	(2,208)
General administrative expenses	(50,213)	(8,482)	(2,091)	173	(60,613)
thereof depreciation and amortisation	(8,318)	(1,122)	(242)	(30)	(9,712)
Other gains/losses from derecognition of financial instruments not at FVPL	-	-	-	(15)	(15)
Impairment result from financial instruments	2,081	4,858	67	1	7,007
Other operating result	(7,558)	(4,462)	(659)	(3,085)	(15,764)
Levies on banking activities	(11,883)	(5,293)	(656)	(552)	(18,384)
Pre-tax result from continuing operations	**33,433**	**20,355**	**6,058**	**(796)**	**59,050**
Taxes on income	(2,674)	(853)	(268)	2,244	(1,551)
Post-tax result from continuing operations	30,759	19,502	5,790	1,448	57,499
Net result for the period	**30,759**	**19,502**	**5,790**	**1,448**	**57,499**
Net result attributable to owners of the parent	**30,759**	**19,502**	**5,790**	**1,448**	**57,499**
Operating income	89,123	28,441	8,741	2,130	128,435
Operating expenses	(50,213)	(8,482)	(2,091)	173	(60,613)
Operating result	**38,910**	**19,959**	**6,650**	**2,303**	**67,822**
Cost/income ratio	56%	30%	24%	-8%	47%
Total assets (eop)	685,595	604,134	165,082	1,003,951	2,458,762
Total liabilities excluding equity (eop)	876,474	475,500	453,909	304,555	2,110,438
Impairments	**2,081**	**4,858**	**67**	**-1,510**	**5,496**
Net impairment loss on financial assets AC	1,817	4,735	102	1	6,655
Net impairment loss on financial assets FVOCI	-	-	(6)	-	(6)
Net impairment loss on finance lease receivables	121	183	-	-	304
Net impairment loss on commitments and guarantees given	143	(60)	(29)	-	54
Net impairment on investments in subsidiaries, joint ventures and associates	-	-	-	(214)	(214)
Net impairment on other non-financial assets	-	-	-	(1,297)	(1,297)

in HUF million	Retail 2017	Corporates 2017	Group Markets 2017	ALM & LCC 2017	Total group 2017
Net interest income	45,985	14,097	4,422	49	64,553
Net fee and commission income	33,153	7,588	1,479	(966)	41,254
Dividend income	-	-	-	2,581	2,581
Net trading result	2,048	3,043	2,948	379	8,418
General administrative expenses	(51,186)	(8,687)	(1,735)	459	(61,149)
thereof depreciation and amortisation	(7,256)	(961)	(206)	(25)	(8,448)
Gains/losses from financial assets and liabilities not at FVPL, net	-	-	-	5,753	5,753
Net impairment loss on financial assets	7,645	3,793	(5)	(9,564)	1,779
Other operating result	(2,536)	1,409	(195)	(5,081)	(6,403)
Levies on banking activities	(9,541)	(3,692)	(179)	(3,507)	(16,919)
Pre-tax result from continuing operations	**26,023**	**21,085**	**6,914**	**2,764**	**56,786**
Taxes on income	(2,079)	(729)	(250)	(1,285)	(4,343)
Post-tax result from continuing operations	23,944	20,356	6,664	1,479	52,443
Net result for the period	**23,944**	**20,356**	**6,664**	**1,479**	**52,443**
Net result attributable to owners of the parent	**23,944**	**20,356**	**6,664**	**1,479**	**52,443**
Operating income	81,186	24,728	8,849	2,043	116,806
Operating expenses	(51,186)	(8,687)	(1,735)	459	(61,149)
Operating result	**30,000**	**16,041**	**7,114**	**2,502**	**55,657**
Cost/income ratio	63%	35%	20%	-23%	52%
Total assets (eop)	630,214	487,086	173,041	853,504	2,143,845
Total liabilities excluding equity (eop)	760,292	473,537	312,283	271,718	1,817,830
Impairments	**6,576**	**22,864**	**(17)**	**(10,911)**	**18,512**
Net impairment loss on loans and receivables to credit institutions/customers	7,645	3,793	(5)	(9,206)	2,227
Net impairment loss on other financial assets	-	-	-	(448)	(448)
Net impairment loss on commitments and guarantees given	(1,067)	19,115	(12)	-	18,036
Net impairment on other non-financial assets	(2)	(44)	-	(1,257)	(1,303)

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

38) Assets and liabilities denominated in foreign currencies

Assets and liabilities not denominated in forint were as follows:

			of which outside Hungary	
in HUF million	2017	2018	2017	2018
Assets	**400,240**	**463,114**	**16,186**	**29,653**
EUR	326,939	401,395	14,281	8,601
CHF	15,830	11,257	51	52
USD	55,938	49,989	475	20,773
JPY	17	17	4	8
Other	1,516	456	1,375	219
Liabilities	**496,264**	**514,660**	**68,877**	**69,630**
EUR	377,108	418,462	63,623	63,287
CHF	6,031	6,340	1,021	1,051
USD	99,846	80,174	3,591	4,559
JPY	1338	1,370	3	9
Other	11,941	8,314	639	724

Further details of the exchange rate open positions in Note 44.4.

39) 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 Bank 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	01.01.2017	31.12.2017	2018
Outstanding minimum lease payments	30,749	35,319	40,573
Non-guaranteed residual values	14,185	6,901	8,936
Gross investment	**44,934**	**42,220**	**49,509**
Unrealised financial income	4,799	2,432	2,424
Net investment	**40,135**	**39,788**	**47,085**
Present value of non-guaranteed residual values	14,185	6,901	8,936
Present value of minimum lease payments	**25,950**	**32,887**	**38,149**
Risk provision related to outstanding minimum lease payments	**(1,750)**	**(663)**	**(547)**

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	**01.01.2017**	**31.12.2017**	**2018**	**01.01.2017**	**31.12.2017**	**2018**
< 1 year	7,108	8,195	12,082	6,201	7,592	10,365
1-5 years	20,900	28,235	33,307	14,603	21,474	24,991
> 5 years	16,926	5,790	4,120	5,146	3,821	2,793
Total	**44,934**	**42,220**	**49,509**	**25,950**	**32,887**	**38,149**

b) Operating leases

Future minimum lease payments under non–cancellable operating leases as at 31 December are, as follows:
Erste Bank 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 Bank Hungary as lessee:			
in HUF million	**01.01.2017**	**31.12.2017**	**2018**
< 1 year	4,217	4,052	4,001
1-5 years	14,553	13,990	9,479
> 5 years	18,139	18,637	4,121
Total	**36,909**	**36,679**	**17,601**

Operating leases where Erste Bank 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.

40) Related party transactions

Besides subsidiaries, the principal shareholder (parent) and minority owners, Erste Bank 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 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
Subsidiaries: the subsidiaries are listed in section 52 of the notes
Other related parties (Erste Group): all companies in Erste Group other than the Hungarian subsidiaries

Loans and advances and amounts owed to related parties

in HUF million	2017	2018
Other demand deposits	**1,031**	**2,641**
Parent	1,031	2,641
Loans and advances to credit institutions[1)]	**9,026**	**40,894**
Parent	925	26,111
Subsidiaries	8,101	14,783
Loans and advances to customers	**75,933**	**34,571**
Subsidiaries	62,774	22,225
Other related parties (Erste Group)	13,159	12,346
Derivative financial instruments - asset	**14,121**	**11,809**
Parent	12,885	10,814
Other related parties (Erste Group)	1,236	995
Other assets	**4,287**	**4,917**
Parent	3,097	2,471
Subsidiaries	975	1,467
Other related parties (Erste Group)	215	979
Deposits by banks	**93,140**	**140,210**
Parent	7,919	5,066
Subsidiaries	83,938	132,021
Other related parties (Erste Group)	1,283	3,123
Customer deposits	**86,164**	**108,901**
Subsidiaries	83,328	106,459
Other related parties (Erste Group)	2,836	2,442
Derivative financial instruments - liabilities	**9,224**	**12,549**
Parent	8,335	11,405
Subsidiaries	889	1,144
Other liabilities	**1,861**	**2,620**
Parent	547	284
Subsidiaries	84	81
Other related parties (Erste Group)	1,230	2,255
Subordinated liabilities	**50,666**	**52,512**
Parent	50,666	52,512

1) Average contractual interest rate:
- 2018: 1.49%
- 2017: 1.57%

Income and expenses to related parties

in HUF million	2017	2018
Interest Income	**1,501**	**3,735**
Parent	759	2,902
Subsidiaries	582	394
Other related parties (Erste Group)	160	439
Interest Expense	**(3,979)**	**(6,264)**
Parent	(2,215)	(3,533)
Subsidiaries	(1,764)	(2,730)
Other related parties (Erste Group)	-	(1)
Fee and commission income	**7,444**	**8,552**
Parent	37	36
Subsidiaries	7,254	8,454
Other related parties (Erste Group)	153	62
Fee and commission expense	**(463)**	**(328)**
Parent	(29)	(29)
Subsidiaries	(434)	(276)
Other related parties (Erste Group)	-	(23)
Dividend income	**2,500**	**4,300**
Subsidiaries	2,500	4,300
Other operating Income/(Expense)	**743**	**663**
Parent	287	168
Subsidiaries	456	473
Other related parties (Erste Group)	-	22

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

Management compensation

in HUF million	2017	2018
Fixed salary	368	376
Performance related compensation	354	338
Other compensation	59	35
Total	**781**	**749**

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.

From 2011, in accordance with Erste Bank'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 recognised as identified staff and the following special rules are applied for their performance related compensation:

- The performance related compensation is based both on Erste Bank 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 Bank 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.

Since the financial year 2010, the variable part of the management board's remuneration, including both cash payments and share-equivalents, is distributed over five years in accordance with legal requirements and is paid out only under certain conditions. Share-equivalents are not exchange-traded shares but phantom shares that are paid out in cash after a one-year vesting period based on defined criteria.

For 2018, performance-linked remuneration and share-equivalents are planned to paid out as the follows:.

Performance related compensation

in HUF million	2017	2018 plan
Cash payment for performance period 2018	59	68
Deferred Bonus in cash for next performance periods	85	102
Deferred Bonus in share equivalent for next performance periods	144	169
Total	**288**	**339**

Breakdown of Supervisory Board and Board of Directors compensation:

in HUF million	2017	2018
Supervisory Board compensation	37	39
Board of Directors compensation	804	775
Total	**841**	**814**

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.
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 2018 the external members of the Supervisory Board received a compensation of 39 million forint per year for the membership (in 2015 7.7; in 2016 23; in 2017 37 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 26 million forint per year for 2018 (in 2015 7.1, in 2016 12; in 2017 24 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.

41) Collateral

The following assets were pledged as security for liabilities:

in HUF million	2017	2018
Loans and receivables to credit institutions and customers	116,279	165,562
Financial assets - available for sale	15,094	x
Financial assets - held to maturity	51,949	x
Financial assets - at AC	x	70,648
Total	**183,322**	**236,210**

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 refinanced mortgage loans in the amount of 133,147 million forint in 2018 (82,692 million forint in 2017) as well as SME loans for a refinancing program with the National bank of Hungary, of 6,086 million forint in 2018 (10,203 million forint in 2017). Details of the program see in Note 11, Other operating result table, comment 2), page 50.
This category also contains encumbered deposits placed for derivative and card transactions.

42) Transfers of financial assets – repurchase transactions and securities lending

Securities lending and repurchase transactions

	2017.01.01		2017.12.31		2018	
in HUF million	Carrying amount of transferred assets	Carrying amount of associated liabilities	Carrying amount of transferred assets	Carrying amount of associated liabilities	Carrying amount of transferred assets	Carrying amount of associated liabilities
Repurchase agreements	**-**	**-**	**1 614**	**1 654**	**15 377**	**15 024**
Financial assets - available for sale	-	-	346	347	x	x
Financial assets - held to maturity	-	-	1 268	1 306	x	x
Financial assets - at AC	x	x	x	x	15 377	15 024
Total	**-**	**-**	**1 614**	**1 654**	**15 377**	**15 024**

The transferred financial instruments consist of bonds and other interest-bearing securities. The total amount of transferred financial assets represent the carrying amount of financial assets in the respective balance sheet positions for which the transferee has a right to sell or repledge. The associated liabilities from repo transaction, which are measured at amortised cost, represent an obligation to repay the borrowed funds.

The following table shows fair values of the transferred assets and associated liabilities for repo transactions with an existing recourse right only on the transferred assets.

	2017.01.01			2017.12.31			2018		
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	Fair value of transferred assets	Fair value of associated liabilities	Net position
Financial assets - available for sale	-	-	-	346	347	(1)	x	x	x
Financial assets - held to maturity	-	-	-	1 287	1 306	(19)	x	x	x
Financial assets - at AC	x	x	x	x	x	x	15 104	15 024	(81)
Total	**-**	**-**	**-**	**1 634**	**1 654**	**(20)**	**15 104**	**15 024**	**(81)**

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

43) Offsetting of financial instruments

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

Erste Bank Hungary employs repurchase agreements and master netting agreements as a means of reducing credit risk of derivative and financing transactions. They qualify as potential offsetting agreements. Master netting agreements are relevant for counterparties with multiple derivative contracts. They provide for the net settlement of all the contracts in the event of default of any counterparty. For derivatives transactions the values of assets and liabilities that would be set off as a result of master netting agreements are presented in the column ‘Financial instruments’. If the net position is further secured by cash collateral or non-cash financial collaterals the effects are disclosed in columns ‘Cash collateral received / pledged’ and ‘Non-cash financial collateral received / pledged’ respectively.

Repurchase agreements are primarily financing transactions. They are structured as a sale and subsequent repurchase of securities at a pre-agreed price and time. This ensures that the securities remain in the hands of the lender as collateral in case the borrower defaults on fulfilling any of its obligations. Offsetting effects from repurchase agreements are disclosed in the column ‘Non-cash financial collateral received / pledged’ respectively. Collateral is presented at the fair value of the transferred securities. However, if the fair value of collateral exceeds the carrying amount of the receivable/liability from the repo transaction the value is capped at the level of the carrying amount. Remaining position may be secured by cash collateral. Cash and non-cash financial collateral involved in these transactions is restricted from being used it by the transferor during the time of the pledge.

Financial assets subject to offsetting and potential offsetting agreements in 2018

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	25,930	-	25,930	10,686	-	-	15,243
Total	**25,930**	**-**	**25,930**	**10,686**	**-**	**-**	**15,243**

Liabilities subject to offsetting and potential offsetting agreements 2018

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	19,839	-	19,839	10,686	-	-	9,153
Repurchase agreements	15,024	-	15,024	-	-	15,021	2
Total	**34,863**	**-**	**34,863**	**10,686**	**-**	**15,021**	**9,156**

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	21,026	-	21,026	8,612	-	-	12,413
Total	**21,026**	**-**	**21,026**	**8,612**	**-**	**-**	**12,413**

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	15,807	-	15,807	8,612	-	-	7,194
Repurchase agreements	1,654	-	1,654	-	-	1,634	20
Total	**17,460**	**-**	**17,460**	**8,612**	**-**	**1,634**	**7,214**

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	15,371	-	15,371	6,802	-	-	8,569
Reverse repurchase agreements	9,809	-	9,809	-	-	9,803	6
Total	**25,180**	**-**	**25,180**	**6,802**	**-**	**9,803**	**8,575**

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	11,590	-	11,590	6,802	-	-	4,788
Repurchase agreements	-	-	-	-	-	-	-
Total	**11,590**	**-**	**11,590**	**6,802**	**-**	**-**	**4,788**

44) Risk management

44.1 Risk policy and strategy

A core function of each bank is taking risks in a conscious and selective manner and professionally steer those risks. Adequate risk policy and risk strategy is essential to a bank's fundamental financial health and operational business success.

EBH has developed a risk management framework that is forward-looking and tailored to its business and risk profile. This framework is based on a clear risk strategy that sets out general principles according to which risk taking must be performed. The risk strategy is consistent with the business strategy and incorporates the expected impact of external environment on the planned business and risk development.

The risk strategy describes current risk profile, defines risk management principles, strategic goals and initiatives for the main risk types, and sets strategic limits for the significant financial and non-financial risk types as defined in the Risk Materiality Assessment. The risk strategy is executed within a clear defined governance structure. This structure applies also monitoring the risk appetite, additional metrics, as well as escalation of limit breaches.

In 2018, management has continued to steer critical portfolios, including active management of non-performing exposures to further strengthen the risk profile. This has been particularly demonstrated by the continuous improvement of the credit quality and the ongoing decrease of non-performing loans and negative risk costs.

The disclosure requirements of the Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (hereinafter Hpt.) Article 122 and the Regulation (EU) No 575/2013 of the European Parliament and the Council on prudential requirements for credit institutions and investment firms; amending regulation (EU) No 648/2012 (CRR) have been implemented throughout the Bank since 1 January 2007. The current Pillar 3 Disclosure Report of Erste Bank is made in accordance with the CRR and the Hungarian legislation, specifically Hpt. The Disclosure Report provides comprehensive disclosure on risks, risk management and capital management. This document is required to be published on a regular basis – once a year – in Hungarian as well as in English. Erste Bank has opted for the Internet as the medium of this publication.

44.2 Risk management organisation

Risk management is achieved through a clear organizational structure with defined roles and responsibilities, delegated authorities and risk limits. Risk management units are completely separate from each business unit. Besides the Risk Governance Committee (RGC) the Bank has also established local committees in order to support efficient decision process and in order to ensure a multi-functional supervision (i.e. ensuring the participation of various fields professions) in risk management, in related principles, in risk strategy forming, harmonizing with business strategy, following up and monitoring the strategy and its execution, as well as strengthening the risk awareness and risk culture. The main objectives of the committees include the promotion of mutual understanding and coordination in the field of corporate and retail lending activities and between the internal management functions.

The following chart illustrates the organizational structure of the risk management area:

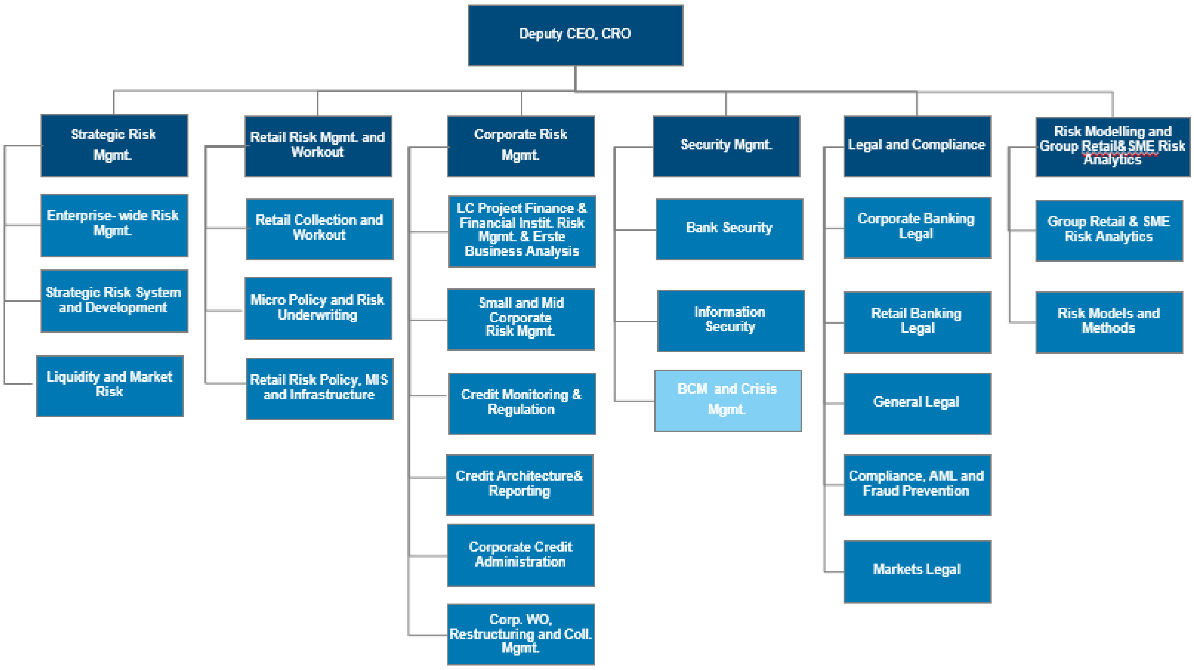
Risk management structure

In order to ensure that the risk management system is in line with the profile and strategy, the Bank has implemented a comprehensive Enterprise-wide Risk Management (ERM hereinafter) Framework. Key components of this framework are:

- the Risk Appetite Statement (RAS);
- Risk Materiality Assessment (RMA);
- Risk-bearing Capacity Calculation (RCC);
- and the Risk Strategy, which frames the above three.

In addition to the elements of the above mentioned ERM framework, the Bank's risk management performs also the following functions:

- Risk planning and forecasting
- Stress Tests



- Recovery Plan
- Risk Reporting System

A fundamental objective of the Bank is to implement its strategic objectives by driving prudent and risk-conscious operations. The Bank lays down its risk management principles in its Risk Strategy. Erste Bank uses a risk management and control system that is proactive and tailored to its business and risk profile. It is based on a clear Risk Appetite Statement (RAS) that is consistent with the Bank's business strategy and focused on early identification and management of risks and trends. In addition to meeting the internal goal of effective and efficient risk management, the Bank's risk management and control system has been developed to fulfil external and, in particular, regulatory requirements. The Bank defines its Risk Strategy and Risk Appetite through the annual planning process to ensure proper alignment of risk, limit system, capital, liquidity and performance targets.

The Bank has always focused on a reliable risk culture. As part of this, proactive behaviour and a strong risk management culture are expected from all employees. In terms of individual behaviour and decision-making, personal integrity and a high level of professionalism are essential.

Risk Appetite Statement (RAS)
The Bank's Risk Appetite Statement (RAS hereinafter) expresses the maximum level of risk that the Bank is willing to accept in order to deliver its business objectives by serving as a starting point for the implementation of the risk limit framework. The risk appetite thus provides a meaningful guidance for the planning process, the tolerances for the core risk metrics and key risk principles to manage risks. It sets the boundary for limits & target setting, and forms a key input into the annual strategic planning process, creating a holistic perspective on capital, liquidity and risk-return trade-offs.

Risk Materiality Assessment (RMA)
The RMA contains the identifications of the risks and the required methodology and testing to determine the materiality of the risk. The main purpose of the risk assessment is to identify and assess material risks and consequently to analyse the risk profile of Erste Bank. Key outputs are used for the limit system of the RAS, for designing elements of a risk management framework, and in the scenario design and selection of the comprehensive stress test.

Risk Strategy
Erste Bank's Risk Strategy forms an essential part of the ERM framework. The Risk Strategy defines the general principles and key elements of the risk management framework to ensure an adequate and consistent implementation of the Risk Strategy. The Strategy combines the principles of prudent risk-taking and risk culture, the outcomes of the RAS and RMA, and the initiatives needed to achieve strategic goals at the level of each type of risk or key business line.

Risk-bearing capacity calculation (RCC)
Within the RCC, all material risks are regularly quantified, aggregated and compared to the coverage potential, to the bank's own funds and to limits set in risk appetite. The result and evaluation of the calculation are part of the regular reports prepared for management, supporting senior management in their decision making processes, in order to comply with prudent risk-taking and risk limits. Insights generated by the assessment are used to improve risk management practices and further mitigate risks within EBH.

Risk reporting systems
The cooperation of the Bank's units in charge of risk management and the managerial reporting system ensures that management is provided with a comprehensive view of the Bank's risk position at all times.
In relation to its risk position, the Bank regularly prepares reports about its risk exposure, actual and forecasted capital position under Pillar I and Pillar II, results of comprehensive and supervisory Stress Testing, liquidity and market risk profile and concentration risk for discussion and approval for decision-making bodies and committees: for the Board of Directors, for the Managing Board, for the Supervisory Board, for the Risk Governance Committee as well as for the Risk Committees.

Risk planning and forecasting
The responsibility for risk management within the Bank includes ensuring sound risk planning and forecasting processes, focusing on both portfolio and economic environment changes. The forecasts determined by risk management are the result of close co-operation with all stakeholders in the Bank's overall planning process, and in particular, with Controlling, Finance and Accounting, Strategic/Corporate/Retail Risk Management and the Asset Liability Management by assessing:

- the expected portfolio quality and impairment levels
- risk-weighted asset management and ensuring capital adequacy
- capital allocation to entities, business lines and segments
- forecasting the liquidity and interest rate risk.

All insights from the ICAAP and controlling processes is used to allocate capital with a view to risk-return considerations.

Recovery plans
In compliance with the Hpt. 114.§ Erste Bank is required to draw up a recovery plan for potential crisis situations. In 2018 an updated Recovery Plan was submitted to the Regulator by the Bank. The Recovery Plan identifies options for restoring financial strength and viability if Erste Bank comes under severe economic stress. The plan specifies potential options for the replenishment of capital and liquidity resources of the bank in order to cope with a range of scenarios including both idiosyncratic and market-wide stress.

Stress Tests
The Bank annually conducts its own impact assessment as the Bank's risk management framework, aiming to assess the Bank's resilience on its consolidated portfolio in a variety of stress situations along with each type of risk. The applied scenarios include possible macroeconomic/business shocks after the acceptance of the participants of the respective decision forum. Stress testing is complemented with target-specific sensitivity tests using tools developed by the Bank. The results revealed by the analysis are fundamental to determining the Bank's risk appetite, which is an integral part of the Bank's risk strategy.

44.3 Credit risk

Credit risk is a fundamental risk for banks, the borrowers are unable to repay the loan and interest at maturity, or do not pay. Lending is one of the main activities in the profile of Erste Bank.
Credit risk related to retail, corporate, municipality, real estate and project loan portfolios are managed to ensure regulatory compliant risk management practices and to provide customers with manageable loan facilities that are within their financial capacities.
The special risk policies and rules of procedures:

- for retail customers are regulated by the Retail Risk Procedure;
- for SMEs and large corporations are regulated by the Corporate Risk Policy
- for municipalities are regulated by the Municipality Risk Policy and
- for real estate and project transactions are regulated by the Property and Project Risk Policy

Quantitative portfolio limits and qualitative risk principles are defined to ensure that the risk profile remains in line with the risk strategy. Moreover the Bank risk management ensures that any new products or change in lending criteria are in line with the group-wide lending framework requirements and are adequately supported by the existing risk infrastructure. Erste Bank also ensures that the local environment (market, competitive, economic, political, and legal/regulatory) is appropriately addressed. A management summary of the key developments is distributed at least quarterly to senior management and key decision makers.

Structure and organisation
As lending is a core profile of the Bank, the Bank regularly identifies, evaluates, manages and monitors credit risk, carried out by the following risk management units:

- Strategic Risk Management,
- Retail Risk and Workout Management,
- Corporate Risk
- Competence Centres

Inner policies define the retail lending framework by establishing policy rules for the entire retail lending cycle covering underwriting, portfolio management, early and late collection. Thus Group-wide retail lending and analytical framework serves as a basis for the Bank's retail lending practices and for identifying potential adverse portfolio developments.
The compliance with inner policies is carried out by the Retail Risk and Workout Management. For new products or sub-products to ensure proper risk rules the Retail Risk and Workout Management also prepares proposal about minimum lending criteria, score cut-off, debt burden % criteria, documentation requirements, verification steps and other risk related parameters to gain approval and ensure proper introduction.
The portfolios risk analytics are operated and managed by the Competence centres through the 'management information system' (MIS) which serves as the analytical background that supports retail risk management decisions with various regular and specific analyses and ensures prudent lending while promoting the 'Managing-through-MIS' approaches and the pro-active, analytics based management of retail loan portfolios on a Bank wide basis.
Strategic Risk Management is responsible for the risk strategy and the related frameworks.
Corporate Risk evaluates credit risks related to large corporate, project and real estate financing, financial institution and municipality clients, makes proposals for credit decision-making as well as controls credit proposals in terms of risk management and compliance with rules.

Credit risk measurement and control

Prior to granting a loan, the creditworthiness of a retail client is determined and confirmed in view of the risk/reward trade-off. Loans can only be granted if the repayment capacity of the borrower is sufficient to serve the regular repayments. Risk-adjusted pricing ensures a balanced relationship between risk and return.

The regular credit risk reports contain information for the Management Board and the risk management committee related to the developments of loan exposures in each key segment, the quality of the portfolio by rating category and detailed risk-relevant information on customers at risk of default or already defaulted. The regular credit risk reports serve as the basis for the business and risk strategy.

The Retail Risk and Workout ensures historical data gathering regarding changes in the risk rule set. It reports the risk rule set changes toward the Group Retail Risk Management (GRRM) on a regular basis to build on up-to-date portfolio monitoring techniques (vintage analysis, delinquency trends, segment analyses, etc.) and to show key drivers behind specific portfolio developments.

Credit decisions and credit processing for the non-retail business must be conducted in accordance with the currently valid authorisation matrix and the work instructions.

Risk mitigation rules

In order to secure its claims, the Bank only takes risk with the proper collaterals. The Bank checks the existence of the collateral, their real value and enforceability, and continuously monitors them during the period of risk.

Interest rate hedging is provided to the extent necessary.

Internal rating system

Erste Bank was authorised by the supervisory authority FMA (for indefinite time) to calculate risk-weighted exposure amounts for credit risk using the IRB Approach from 1st April 2008. (IRB Official Notice 28 Mar 2008; IRB official notice for single banking entities and at consolidated level for institutions abroad.)

It annually performs validation of the credit risk models according to the applicable regulations.

The following segments fall under the Advanced IRB Approach:

- Retail

The following segment falls under the Foundation IRB Approach:

- Corporate
- Institutions
- Central government and central bank
- Institutions
- Corporate / Special Lending (Real Estate Financing).

Rating systems and use of ECAIs

A rating system comprises all models, methods, processes, controls, data collection and data processing processes that serve the assessment of credit risks, the allocation of exposures to rating grades and the quantification of default probabilities for certain types of exposures.

The rating systems used by Erste Bank meet the requirements for the application of the IRB Approach.

External rating are applied on sovereign customers as an input (Moody's rating is applied) to the local model. Other clients are rated internally.

Rating Models and Methods

The internal rating models and the estimates of the risk parameters play a key role in credit risk management, in the decision-making processes and in lending operations. Furthermore, they deliver the main determinants for the procedures to assess the capital requirement. Erste Bank uses empirical-statistical and expert-based model types. A periodical validation assures the quality of the rating models and risk parameters.

The purpose of customer rating is the best possible estimation of customer related risks, i.e. to establish the probability of default of the customer within one year (Probability of Default, PD).

.

Risk assessment is primarily based on the customer rating, however decisions regarding the individual credit risks are not based solely on the customer rating, but they are made with the apprehensive consideration of risk factors.

Within this framework, in addition to the customer and the customer risks any potential third party in the transaction and, in certain cases, the collateral are also the subject of the review.

The rating method to be used is determined depending on customer classification:
- Retail
- Corporates
- Banks
- Sovereigns

Every customer is assigned a certain rating method, as follows:

Exposure Classes	STATISTICAL MODEL	EXPERT MODEL
Retail, commercial	✓	
Corporate	✓	✓
SME	✓	
SL (IPRE)		✓
Institutions		✓
Central government and central banks		✓
Country		✓
Equities	✓	✓

The rating methods Bank rating and country rating are used as centralised methods throughout Erste Group without any regional modifications and are made available to the Group companies.
The other rating methods (rating private individuals, rating SME, rating corporates and rating specialised lending) follow uniform modelling guidelines. At Erste Bank model structures feature regional adaptations appropriate to the respective portfolios.
As of 2011, the models are being developed at competence centres in order to achieve higher quality, efficiency and consistency by pooling modelling expertise.

Procedures for checking the reliability of rating systems

Rating systems are reviewed at least once a year by Erste Holding’s competence centres. The review is based on Group standards. For retail portfolios both the application and the behavioural scorecards are checked. In the course of back-testing the Bank – together with the competence centres - examines, among others, the rating distribution, calibration and discriminatory power. If required based on the review, the models are adjusted or redeveloped.
Customer rating is used for corporate credit portfolios, the review of which is carried out similarly to that of the retail portfolio.

The structure of the internal rating system and the link between internal and external ratings

Depending on the customer type and the product the Bank uses systems that are using customer and product data to establish the rating. Where this is not available, the rating is established based on the procedure set forth in a separate policy.
The rating systems applied by the Bank have been established based on the standards valid for the Erste Holding subsidiaries and in accordance with the Hungarian regulations. The rating system of the Bank is validated by Erste Holding Validation Unit with annual frequency.
The management of the Bank is regularly notified about the validation results. If the validation process discovers deficiencies concerning rating system of the Bank, and the related processes, the Bank is required to define and implement risk mitigation measures in the relevant fields of the Risk Management of the Bank.

Ratings provided by external credit rating agencies are matched to the ratings provided by the internal rating system for each agency.
According to Article 4 (98) CRR, external credit assessment institution (ECAI) means a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009.
The Bank used by external rating agencies and credit quality categories are as follows:

Moody's	OECD Country Risk Ratings	Credit Quality Step
Aaa to Aa3	0 to 1	1
A1 to A3	2	2
Baa1 to Baa3	3	3
Ba1 to Ba3	4 to 5	4
B1 to B3	6	5
Caa1 and below	7	6

Art. 444. d) CRR - Allocation of the external ratings to credit quality steps

Description of the rating process

The Bank uses different rating systems for central governments and central banks, credit institutions, local governments, leasing companies, insurance companies, business entities, project companies, retail customers and other organizations.

When rating any customer, the Bank considers objective and quantifiable as well as subjective and non-quantifiable aspects. With reliance on the review of the portfolio, the information originating from the rating process is continuously measured against historic data.

The Bank's IRB rating systems and its rating methods are back-tested and validated yearly, in line with regulatory requirements.

Rating of central governments or central banks
Central governments and central (or national) banks are rated on the level of Erste Holding with the use of a special rating system introduced in 1993 and regularly reviewed. The rating has a special focus on the short-, medium- and long-term risk of foreign currency indebtedness.

The country risk is regarded to be equivalent to the risk carried by the central government, including the government itself, the central (national) bank and the institutions that are backed by the government's joint and several suretyship. The rating is updated on a quarterly basis in order to moderate the distorting effects of the quickly changing environment. The risk model distinguishes two country types: industrial and developing (emerging) markets.

Rating of credit institutions and investment enterprises
To rate credit institutions and investment enterprises, Erste Holding uses its own, dedicatedly developed model. This rating system is an expert model based on the combination of quantitative, qualitative and country risk criteria, to the risk transfer be covered.

Rating of enterprises
When rating business companies, the Bank is required to examine capital endowment, capital structure, liquidity, profitability and debt service. In addition to the foregoing, the system for the analysis of the balance sheet calculates other indicators for assessment, as well. Beside historic figures, the Bank also considers future expectations in the course of rating. Subjective aspects reviewed on a mandatory basis: ownership structure, professional image of the management, market situation and its expected trends, composition of orders, sectoral information, evaluation of future outlooks, quality of planning.
The Bank uses a 13+R level borrower rating system for enterprises: 1 – Virtually risk-free; 2 – Minimum risk; 3 – Low risk; 4a, 4b, 4c – Risk under the average level; 5a,5b, 5c – Average risk level; 6a – 6b Risk over the average level; 7 – Exposure limit; 8 – Early warning; R1-5 – Default.

Rating of retail customers
To determine the rating of exposures within the Bank's retail portfolio, product-specific scorecards are used.
These product-specific scorecards, combined with the customer level scorecards, are integrated into a customer-level rating system.
The rating scale that is applied to private persons within the retail portfolio (and also presented in the capital calculation) has 8+R grades.
Micro-entrepreneurial customers are rated on a scale of 13+R grades, identically to corporate customers.

Participations
The Bank rates its participations on a quarterly basis. The rating categories and provisioning rates belonging to participations are established with respect to their book values in the Bank's records and their fair (market) values. When rating a participation, it is to be considered what tendencies the business operations of the company show in comparison with the previous years, and what changes can be anticipated in the short and medium run.
The Bank is not involved in activities for the acquisition of participations for profit.

The process used to transfer the issuer and issue credit assessments onto items not included in the trading book
Issuers are rated the same way as other customers. External rating are applied on sovereign customers as an input (Moody's rating is applied) to the local model. Other clients are rated internally.
Other clients are rated internally.

Probability of default (PD)

PD estimates the probability of the customer falls in default.

EBH uses two methods for PD estimation under IFRS9:

- R3:

Average default rate analysis
This method is based on observation of a default at time t after client's rating. From every client's observation we examine all his following observations until he either defaults or disappears from data sample.
Marginal PD at time t for rating i is estimated as

$$MPD_i(t) = \frac{n_{iR}(t)}{\sum_{\forall j} n_{ij}(t)}$$

where n_ij (t) is the number of all migrations of clients from rating i to rating j (default and nondefault) after t time units given that the client survived till t-1 and R denotes the defaulted rating

- C2:

External Matrix approach
The shape of MPD (and CPD) curves is derrived from external sources - one year and/or multiple year transition matrices published by rating agencies. Internal ratings are then mapped to external ratings based on one year probability of default of external ratings and one-year PD scale of a given portfolio.

The validation itself is executed annually by the Erste Holding Validation unit as an independent team of experts. Validation includes the backtesting of both the portfolio level PD as well as the long-term PD estimated for rating categories, and the comparison with empirical portfolio level default rates and the long term, rating-category based default rates. According to the methodology approved by the supervision authority, if the validation analysis detects an underestimation, a re-estimation is required.

Loss given default (LGD)

LGD is used to estimate the volume of a loss that is suffered by the Bank on average on a transaction having gone default, with respect to the costs associated with receivables collection and the time value of money. The absolute volume of the loss is projected to the total value of the receivables outstanding in relation to the given transaction (= exposure at default ~ EAD) at the time of the occurrence of the default event.

The Bank applies its own loss given default (LGD) estimates in the retail segment.

LGD is validated annually by the Erste Holding Validation Unit. It basically embraces the revision of pools, an overview of changes in the workout processes, the comparison of the newly available factual information with the earlier estimates and the review of the macro-correction of the estimates, and therefore it involves both quantitative and qualitative elements. If the validation back testing proves on the basis of the actual empirical data that the estimated LGD parameters are not conservative enough, a management intervention and a re-estimation is required. The bank uses recovery data on product level in on order to estimate the LGD and this process is based on the internal database.

.

Credit conversion factor (CCF)

CCF shows what ratio of the off-balance limit still unutilised at the reference time is expected to be drawn down by the customer until the date of default. In the capital calculation, this amount is still to be added to the part of the off-balance limit that has already been drawn to establish the estimated value of the exposure at default (EAD).
The Bank estimates the credit conversion factor (CCF) for the revolving type products (current account overdrafts and credit cards) of the retail segment.

Since 2009, the preferred method has been the so-called „variable time horizon method" (having replaced the so-called „fixed time horizon" method) that considers that the event of default may occur at any time within the 12 months (and not exactly in 12 months) following the date of the capital calculation.

CCF is validated annually by Erste Holding Validation unit. It basically embraces the review of pools, an overview of changes in the relevant banking processes (e.g. current account monitoring), the comparison of the newly available factual information with the earlier estimates and the review of the necessity of the macro-correction, and therefore it involves both quantitative and qualitative elements.

Control Mechanism for Rating System

Every new IRB model developed must be reviewed prior to use by the Independent Group Validation department. Compliance with development standards and the quality of the results are assessed based on documented validation standards.
The validation procedures and methods are further detailed in Erste Group's Disclosure Report:
https://www.erstegroup.com/en/investors/reports/regulatory-reports

Quantitative disclosure on credit risk

As regards to exposures in the IRB Approach, a breakdown is given in the Annex of the exposure classes of central governments and central banks, institutions, corporates, retail and equity by PD classes, exposure, outstanding loans, undrawn commitments, EAD and EAD-weighted average RWs.
For the exposure class retail – which is the only exposure class for which LGD estimates are made – an additional presentation is given by EAD-weighted average LGD.

Credit risk exposure

Credit risk exposure relates to the sum of the following balance sheet items:

- cash and cash balances - demand deposits to central and credit institutions;
- debt instruments held for trading;
- non-trading debt instruments at fair value through profit or loss (FVPL);
- debt instruments at fair value through other comprehensive income (FVOCI);
- debt instruments at amortised cost (AC), other than trade and other receivables;
- debt instruments held for sale in disposal groups;
- finance lease receivables;
- trade and other receivables (for disclosure purposes in the tabular summaries below, any contract assets are also included in this category);
- positive fair value of derivatives;
- off-balance sheet credit risks (primarily financial guarantees and undrawn irrevocable credit commitments).

The credit risk exposure equates the gross carrying amount (or nominal value in the case of off-balance sheet positions) excluding:

- account loan loss allowances;
- provisions for guarantees;
- any collateral held (including risk transfer to guarantors);
- netting effects;
- other credit enhancements;
- credit risk mitigating transactions.

Reconciliation between the gross carrying amount and the carrying amount of the credit risk exposure components

in HUF million	Credit risk exposure	Credit loss allowances	Adjustments	Net carrying amount
As of 31 December 2018				
Cash and cash balances - demand deposits to central banks and credit institutions	4,895	2		4,893
Derivatives and debt instruments held for trading	91,130	-		91,130
Non-trading debt instruments at FVPL	72,434	-		72,434
Debt securities	30,702	-		30,702
Loans and advances to customers	41,732	-		41,732
Debt instruments at FVOCI	134,035	26	1,560	135,569
Debt securities	134,035	26	1,560	135,569
Debt instruments at AC	2,007,144	40,690		1,966,454
Debt securities	658,717	736		657,981
Loans and advances to banks	95,692	62		95,630
Loans and advances to customers	1,252,734	39,891		1,212,843
Trade and other receivables	14,171	58		14,113
Finance lease receivables	38,149	547		37,602
Off balance-sheet exposures	475,937	3,169		472,768
Total	**2,837,894**	**44,491**	**1,560**	**2,794,963**

in HUF million	Gross carrying amount	Credit risk provisions	Carrying amount
As of 31 December 2017			
Cash and cash balances – other demand deposits	1,031	-	1,031
Loans and receivables to credit institutions	61,242	-	61,242
Loans and receivables to customers	1,237,033	57,501	1,179,531
Financial assets - held to maturity	575,440	-	575,440
Financial assets - held for trading	52,042	-	52,042
Financial assets - available for sale	127,357	-	127,357
Positive fair value of derivatives	21,026	-	21,026
Contingent liabilities	299,902	3,560	296,341
Total	**2,375,073**	**61,062**	**2,314,011**

in HUF million	Gross carrying amount	Credit risk provisions	Carrying amount
As of 31 December 2016			
Cash and cash balances – other demand deposits	11,048	-	11,048
Loans and receivables to credit institutions	145,875	-	145,875
Loans and receivables to customers	1,104,172	78,410	1,025,762
Financial assets - held to maturity	395,338	-	395,338
Financial assets - held for trading	101,360	-	101,360
Financial assets - available for sale	134,929	-	134,929
Positive fair value of derivatives	15,371	-	15,371
Contingent liabilities	217,434	21,664	195,770
Total	**2,125,527**	**100,074**	**2,025,453**

Credit risk provisions comprise impairments for financial assets measured at amortised cost (including finance lease and trade receivables) and at fair value through other comprehensive income (FVOCI), as well as provisions for off-balance sheet exposures. Adjustments refer to the fair value changes of the carrying amount for financial assets at FVOCI.

The gross carrying amount of contingent liabilities refers to the nominal value, while credit risk provisions refer to provisions for guarantees. A carrying amount is not presented in the case of contingent liabilities.

Breakdown of credit risk exposure

On the next pages the credit risk volume is categorised in the following way:

- Basel 3 exposure class and financial instrument;
- off-balance sheet exposure by product;
- industry and financial instrument;
- industry and IFRS 9 treatment;
- risk category;
- industry and risk category;
- region and risk category;
- region and IFRS 9 treatment;
- business segment and risk category;
- business segment and IFRS 9 treatment;
- non-performing credit risk exposure by business segment and credit loss allowances;
- composition of credit loss allowances;
- credit risk exposure, forbearance exposure, and credit loss allowances;
- types of forbearance exposure;
- credit quality of forbearance exposure by geographical segments;
- business segment and collateral;
- geographical segment and collateral;
- financial instrument and collateral;
- credit risk exposure neither past due nor credit impaired by financial instrument and risk category;
- credit risk exposure past due and not covered by credit loss allowances by financial instrument and collateralisation.

Credit risk exposure by Basel 3 exposure class and financial instrument

The assignment of obligors to Basel 3 exposure classes is based on legal requirements. For reasons of clarity, individual Basel 3 exposure classes are aggregated in the tables below. In addition to central governments, central banks, international organisations, and multinational development banks, the aggregated exposure class "sovereigns" contains regional and local governments as well as public sector entities. Institutions include banks and recognised investment firms.

					At amortised cost						
in HUF million	Cash and cash balances - demand deposits to central banks and credit institutions	Derivatives and debt instruments held for trading	Non-trading debt instruments at FVPL	Debt instruments at FVOCI	Debt securities	Loans and advances to banks	Loans and advances to customers	Trade and other receivables	Finance lease receivables	Off balance-sheet exposures	Total
As of 31 December 2018											
Sovereigns	-	42,611	30,702	123,965	625,133	23,489	0.05	719	-	-	846,619
Institutions	4,895	42,202	78	10,070	17,463	57,389	35,460	2,105	0.22	61,190	230,854
Corporates	0.04	6,317	604	-	16,121	14,813	540,842	11,345	35,398	283,763	909,202
Retail	-	1	41,050	-	-	-	676,432	1	2,751	130,984	851,219
Total	**4,895**	**91,130**	**72,434**	**134,035**	**658,717**	**95,692**	**1,252,734**	**14,171**	**38,149**	**475,937**	**2,837,894**

				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 2017										
Sovereigns	-	28,985	3,643	511,915	20,942	-	107,650	1,602	30,000	704,737
Institutions	1,031	32,257	84,603	63,525	31,100	-	-	15,383	16,143	244,042
Corporates	-	-	474,744	-	-	-	19,708	4,041	149,077	647,570
Retail	-	-	674,042	-	-	-	-	-	104,682	778,724
Total	**1,031**	**61,242**	**1,237,033**	**575,440**	**52,042**	**-**	**127,357**	**21,026**	**299,902**	**2,375,073**

in HUF million	Cash and cash balances – other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Debt securities: Financial assets - held to maturity	Debt securities: Financial assets - held for trading	Debt securities: Financial assets - at fair value through profit or loss	Debt securities: Financial assets - available for sale	Positive fair value of derivatives	Contingent liabilities	Total credit risk exposure
	At amortised cost				At fair value					
As of 31 December 2016										
Sovereigns	-	76,579	540	395,338	101,159	-	110,356	-	60,000	743,971
Institutions	11,048	69,296	70,088	-	201	-	24,573	11,939	25,530	212,675
Corporates	-	-	387,166	-	-	-	-	3,430	101,788	492,383
Retail	-	-	646,378	-	-	-	-	2	30,117	676,497
Total	**11,048**	**145,875**	**1,104,172**	**395,338**	**101,360**	**-**	**134,929**	**15,371**	**217,434**	**2,125,527**

Contingent liabilities / Off balance sheet exposures by product

in HUF million	As of 31 December 2017	As of 31 December 2018
Financial guarantees	31,710	308
Irrevocable commitments	268,191	-
Loan commitments	-	429,334
Other commitments	-	46,295
Total	**299,902**	**475,937**

Credit risk exposure by industry and financial instrument

					At amortised cost						
in HUF million	Cash and cash balances - demand deposits to central banks and credit institutions	Derivatives and debt instruments held for trading	Non-trading debt instru-ments at FVPL	Debt instruments at FVOCI	Debt securities	Loans and advances to banks	Loans and advances to customers	Trade and other receivables	Finance lease receivables	Off balance-sheet exposures	Total
As of 31 December 2018											
Agriculture and forestry	-	20	39	-	-	-	34,598	262	4,800	12,975	52,694
Mining	-	-	-	-	-	-	96	-	16	1,129	1,241
Manufacturing	-	301	101	-	-	-	115,703	2,218	2,118	89,380	209,822
Energy and water supply	-	747	20	-	1,083	-	13,164	1,909	288	18,333	35,544
Construction	-	-	-	-	-	-	19,733	56	534	16,970	37,293
Development of building projects	-	41	-	-	-	-	10,216	-	-	929	11,186
Trade	-	41	76	-	-	-	57,351	6,250	3,066	27,834	94,617
Transport and communication	-	157	222	-	-	-	18,206	46	19,960	10,687	49,278
Hotels and restaurants	-	1,250	166	-	-	-	8,969	13	325	2,169	12,892
Financial and insurance services	4,895	167	-	10,070	32,474	95,692	106,780	2,106	53	105,329	357,565
Holding companies	-	-	-	-	-	-	36,963	-	8	38,983	75,954
Real estate and housing	-	49,624	-	-	27	-	163,172	-	227	20,224	233,275
Services	-	1	27	-	13,127	-	38,102	588	3,622	8,762	64,229
Public administration	-	2,613	30,780	123,965	612,006	-	14,597	719	-	37,992	822,671
Education, health and art	-	2	38	-	-	-	1,943	-	501	865	3,349
Households	-	-	40,966	-	-	-	660,228	3	2,639	123,286	827,122
Other	-	36,207	-	-	-	-	93	-	-	2	36,302
Total	**4,895**	**91,130**	**72,434**	**134,035**	**658,717**	**95,692**	**1,252,734**	**14,171**	**38,149**	**475,937**	**2,837,893**

.

in HUF million	Cash and cash balances – other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Debt securities: Financial assets - held to maturity	Debt securities: Financial assets - held for trading	Debt securities: Financial assets - at fair value through profit or loss	Debt securities: Financial assets - available for sale	Positive fair value of derivatives	Contingent liabilities	Total credit risk exposure
			At amortised cost				At fair value			
As of 31 December 2017										
Agriculture and forestry	-	-	34,482	-	-	-	-	-	487	34,970
Mining	-	-	12,235	-	-	-	-	-	687	12,921
Manufacturing	-	-	124,756	-	-	-	-	235	81,029	206,021
Energy and water supply	-	-	13,707	-	-	-	-	21	6,480	20,208
Construction	-	-	6,389	-	-	-	-	1	9,153	15,544
Trade	-	-	56,921	-	-	-	-	98	9,963	66,982
Transport and communication	-	-	31,322	-	-	-	-	1,734	1,149	34,205
Hotels and restaurants	-	-	10,296	-	-	-	-	-	1,352	11,648
Financial and insurance services	1,031	61,242	19,270	63,525	31,100	-	-	15,511	16,143	207,823
Real estate and housing	-	-	150,196	-	-	-	-	2,022	36,509	188,726
Services	-	-	103,676	-	-	-	-	1,391	2,334	107,401
Public administration	-	-	3,824	511,915	20,942	-	127,357	-	30,000	694,038
Education, health and art	-	-	3,285	-	-	-	-	-	35	3,320
Private households	-	-	666,674	-	-	-	-	-	104,580	771,254
Other	-	-	-	-	-	-	-	12	-	12
Total	**1,031**	**61,242**	**1,237,033**	**575,440**	**52,042**	**-**	**127,357**	**21,026**	**299,902**	**2,375,073**

in HUF million	Cash and cash balances – other demand deposits (At amortised cost)	Loans and receivables to credit institutions (At amortised cost)	Loans and receivables to customers (At amortised cost)	Debt securities: Financial assets - held to maturity (At amortised cost)	Debt securities: Financial assets - held for trading (At fair value)	Debt securities: Financial assets - at fair value through profit or loss (At fair value)	Debt securities: Financial assets - available for sale (At fair value)	Positive fair value of derivatives	Contingent liabilities	Total credit risk exposure
As of 31 December 2016										
Agriculture and forestry	-	-	27,481	-	-	-	-	7	649	28,138
Mining	-	-	12,537	-	-	-	-	-	807	13,344
Manufacturing	-	-	73,864	-	-	-	-	790	56,477	131,131
Energy and water supply	-	-	9,186	-	-	-	-	55	2,217	11,458
Construction	-	-	5,414	-	-	-	-	-	6,720	12,134
Trade	-	-	49,179	-	-	-	-	21	9,123	58,322
Transport and communication	-	-	21,367	-	-	-	-	9	359	21,735
Hotels and restaurants	-	-	11,793	-	-	-	-	-	78	11,871
Financial and insurance services	11,048	145,875	6,551	-	201	-	24,573	10,472	47	198,767
Real estate and housing	-	-	169,165	-	-	-	-	2,869	24,294	196,327
Services	-	-	72,114	-	-	-	-	1,149	27,027	100,290
Public administration	-	-	1,369	395,338	101,159	-	110,356	-	60,000	668,222
Education, health and art	-	-	2,921	-	-	-	-	-	3	2,924
Private households	-	-	641,227	-	-	-	-	-	29,632	670,859
Other	-	-	5	-	-	-	-	-	-	5
Total	**11,048**	**145,875**	**1,104,172**	**395,338**	**101,360**	**-**	**134,929**	**15,371**	**217,434**	**2,125,527**

.

Credit risk exposure by industry and IFRS 9 treatment

in HUF million	Stage 1	Stage 2	Stage 3	POCI	Credit risk exposure (AC and FVOCI)	Subject to provision	Total
As of 31 December 2018							
Agriculture and forestry	50,726	1,507	36	9	52,635	417	52,694
Mining	346	1	-	-	1,241	894	1,241
Manufacturing	201,184	748	63	363	209,420	7,464	209,822
Energy and water supply	31,324	267	1,089	248	34,777	2,615	35,544
Construction	25,224	322	1,470	618	37,293	9,701	37,333
Development of building projects	10,689	30	5	332	11,145	130	11,186
Trade	85,100	1,680	1,423	198	94,500	6,332	94,733
Transport and communication	42,639	834	18	403	48,899	6,477	50,372
Hotels and restaurants	11,188	235	25	17	11,476	343	11,808
Financial and insurance services	345,430	934	1	11	340,340	60,646	407,022
Holding companies	66,552	554	-	-	75,954	8,849	75,955
Real estate and housing	166,540	2,992	974	10,549	183,651	5,209	186,263
Services	61,141	1,068	98	186	104,694	1,740	64,232
Public administration	789,279	-	-	-	789,279	66,987	856,265
Education, health and art	3,201	69	4	5	3,309	68	3,347
Households	705,525	30,395	24,058	26,177	786,156	40,966	827,122
Other	88	2	3	3	95	-	95
Total	**2,518,934**	**41,053**	**29,262**	**38,786**	**2,697,765**	**209,859**	**2,837,894**

Subject to provision: other commitments are still measured under IAS 37, however, impairment are calculated for them as well.

Credit risk exposure by risk category

in HUF million	Low risk	Management attention	Substandard	Non-performing*	Total
As of 31 December 2018	**2,449,061**	**250,685**	**85,697**	**52,452**	**2,837,894**
Share of credit risk exposure	**86.3%**	**8.8%**	**3.0%**	**1.8%**	**100.0%**
As of 31 December 2017	**2,131,301**	**145,508**	**32,435**	**65,829**	**2,375,073**
Share of credit risk exposure	89.74%	6.13%	1.37%	2.77%	100.00%

*Non-performing exposures:

The EBA Guideline for non-performing exposures comprises all defaulted exposures and all forborne exposures in monitoring/probation period which show an on-going deteriorating credit quality and is broader defined than the default stemming from CRR.

The non-performing but not defaulted status must be assigned to clients with forborne accounts who need again forbearance measures or exceed 30 DPD but do not meet the criteria of default. This means that the previous granted forbearance measure could not improve the situation of the client. Consequently all non-performing exposures which belong to not defaulted clients must have received a forbearance measure in the past.

The non-performing definition comprises

.

1) all defaulted exposures:
   a) more than 90 days overdue above the materiality threshold; or
   b) which are unlikely to be repaid;
2) and the following cases in addition:
   a) performing forborne exposure "under probation" (PFUP) which becomes 30 days past due on the forborne account; or
   b) client with exposure in performing "under probation" (PFUP) who receives a "second restructuring" on any account unless conditions for E3 are met; or
   c) in case of non-retail a final forbearance measures was not implemented within 18 months (see above preliminary forbearance measures in chapter 3.2 Financial difficulty).

Credit risk exposure by industry and risk category

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2018					
Agriculture and forestry	45,218	5,425	2,009	42	52,694
Mining	165	1,073	4	-	1,241
Manufacturing	191,036	14,405	4,108	273	209,822
Energy and water supply	29,654	4,176	376	1,338	35,544
Construction	27,903	4,954	1,946	2,531	37,333
Development of building projects	10,568	63	218	337	11,186
Trade	75,964	13,969	3,128	1,672	94,733
Transport and communication	39,518	10,019	812	22	50,372
Hotels and restaurants	10,055	1,121	590	42	11,808
Financial and insurance services	399,971	3,443	3,236	372	407,022
Holding companies	73,771	1,116	1,067	-	75,955
Real estate and housing	161,762	9,305	14,216	980	186,263
Services	50,190	11,949	1,837	256	64,232
Public administration	856,265	-	-	-	856,265
Education, health and art	1,720	919	703	4	3,347
Households	559,575	169,914	52,717	44,916	827,122
Other	65	13	15	3	95
Total	**2,449,061**	**250,685**	**85,697**	**52,452**	**2,837,894**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2017					
Agriculture and forestry	26,958	7,590	2	421	34,970
Mining	12,357	564	-	-	12,921
Manufacturing	189,941	15,068	286	726	206,021
Energy and water supply	15,050	2,159	1,116	1,884	20,208
Construction	12,316	3,069	9	150	15,544
Trade	58,349	7,218	157	1,258	66,982
Transport and communication	31,348	2,633	40	184	34,205
Hotels and restaurants	10,480	668	450	50	11,648
Financial and insurance services	207,819	4	-	-	207,823
Real estate and housing	161,101	9,431	14,732	3,463	188,726
Services	102,455	4,518	117	311	107,401
Public administration	693,847	11	-	181	694,038
Education, health and art	884	1,024	1,411	1	3,320
Private households	608,398	91,540	14,115	57,201	771,254
Other	-	12	-	-	12
Total	**2,131,301**	**145,508**	**32,435**	**65,829**	**2,375,073**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2016					
Agriculture and forestry	20,385	7,533	2	219	28,138
Mining	12,809	534	1	-	13,344
Manufacturing	117,902	9,368	407	3,454	131,131
Energy and water supply	7,497	154	1	3,806	11,458
Construction	8,956	2,802	26	350	12,134
Trade	47,000	9,340	193	1,789	58,322
Transport and communication	16,733	4,221	30	751	21,735
Hotels and restaurants	10,635	575	529	132	11,871
Financial and insurance services	183,692	15,014	-	61	198,767
Real estate and housing	129,405	15,054	13,567	38,302	196,327
Services	90,970	7,540	185	1,594	100,290
Public administration	667,388	-	-	834	668,222
Education, health and art	736	540	1,592	57	2,924
Private households	481,574	101,097	17,845	70,344	670,859
Other	-	5	-	-	5
Total	**1,795,682**	**173,775**	**34,377**	**121,693**	**2,125,527**

Credit risk exposure by region and risk category

The geographic analysis of credit exposure is based on the country of risk of the borrower and counterparty. It comprises obligors domiciled in other countries if the economic risk exists in the respective country of risk.

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2018					
Core markets	**2,441,461**	**250,041**	**85,237**	**52,191**	**2,828,930**
Austria	39,989	45	308	6	40,348
Croatia	11	1	16	11	39
Romania	713	205	56	41	1,016
Serbia	17	23	4	1	45
Slovakia	549	122	17	22	710
Czech Republic	1,751	6	2	-	1,760
Hungary	2,398,431	249,638	84,834	52,110	2,785,013
Other EU	**4,751**	**493**	**281**	**127**	**5,652**
Other industrialised countries	**2,582**	**9**	**61**	**3**	**2,655**
Emerging markets	**267**	**142**	**117**	**130**	**656**
South-eastern Europe/CIS	97	37	37	82	253
Asia	91	19	27	34	170
Latin America	25	32	3	-	60
Middle East/Africa	55	54	50	15	173
Total	**2,449,061**	**250,685**	**85,697**	**52,452**	**2,837,894**

.

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2017					
Core markets	**2,126,406**	**144,841**	**32,343**	**65,377**	**2,368,966**
Austria	15,283	41	3	3	15,329
Croatia	12,108	17	1	9	12,134
Romania	937	218	12	91	1,258
Serbia	63	18	8	2	91
Slovakia	667	64	17	24	773
Czech Republic	1,963	-	1	7	1,972
Hungary	2,095,385	144,483	32,300	65,241	2,337,409
Other EU	**3,065**	**424**	**46**	**281**	**3,817**
Other industrialised countries	**964**	**31**	**15**	**1**	**1,011**
Emerging markets	**866**	**213**	**31**	**170**	**1,279**
South-eastern Europe/CIS	216	99	10	79	404
Asia	350	49	17	70	486
Latin America	22	8	3	2	36
Middle East/Africa	277	57	1	19	354
Total	**2,131,301**	**145,508**	**32,435**	**65,829**	**2,375,073**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2016					
Core markets	**1,784,318**	**172,559**	**34,248**	**120,944**	**2,112,070**
Austria	43,908	197	1	0	44,107
Croatia	12,455	16	1	10	12,482
Romania	814	385	42	176	1,416
Serbia	44	19	8	2	72
Slovakia	467	60	2	20	548
Czech Republic	1,632	3	1	6	1,643
Hungary	1,724,998	171,880	34,194	120,731	2,051,802
Other EU	**3,304**	**955**	**91**	**389**	**4,739**
Other industrialised countries	**7,349**	**14**	**8**	**103**	**7,474**
Emerging markets	**711**	**247**	**31**	**256**	**1,245**
South-eastern Europe/CIS	240	59	6	99	404
Asia	311	38	24	78	450
Latin America	12	55	-	20	87
Middle East/Africa	148	96	1	59	304
Total	**1,795,682**	**173,775**	**34,377**	**121,693**	**2,125,527**

Credit risk exposure by region and IFRS 9 treatment

in HUF million	Stage 1	Stage 2	Stage 3	POCI	Credit risk exposure (AC and FVOCI)	Subject to provision	Total
As of 31 December 2018							
Core markets	**2,512,325**	**40,889**	**29,158**	**38,626**	**2,620,997**	**207,933**	**2,828,930**
Austria	29,475	9	5	1	29,489	10,859	40,348
Croatia	28	-	1	9	39	-	39
Romania	891	21	10	53	975	41	1,016
Serbia	41	4	1	-	45	-	45
Slovakia	656	9	22	3	690	21	710
Czech Republic	15	2	-	-	17	1,742	1,760
Hungary	2,481,219	40,843	29,120	38,559	2,589,742	195,271	2,785,013
Other EU	**3,542**	**104**	**57**	**70**	**3,774**	**1,879**	**5,652**
Other industrialised countries	**2,625**	**27**	**3**	**-**	**2,655**	**-**	**2,655**
Emerging markets	**442**	**33**	**44**	**90**	**609**	**47**	**656**
South-eastern Europe/CIS	147	13	14	68	242	11	253
Asia	124	12	17	17	170	-	170
Latin America	56	1	-	-	57	3	60
Middle East/Africa	115	7	13	5	140	34	173
Total	**2,518,934**	**41,053**	**29,262**	**38,786**	**2,628,035**	**209,859**	**2,837,894**

Stage 1 and Stage 2 comprise not impaired credit risks while Stage 3 includes impaired credit risks. POCI (purchased or originated credit impaired) consists of credit risks already impaired when purchased or originated.

Credit risk exposure by reporting segment and risk category

The segment reporting of EBH is based on the matrix organisation by business segment as well as by geographical segment. The geographical segmentation follows the country markets in which EBH operates and the locations of the banking and other financial institutions participations.

Credit risk exposure by business segment and risk category

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2018					
Retail	567,430	183,336	56,447	45,610	852,823
Corporates	799,700	65,223	27,111	6,842	898,876
Group Markets	1,081,687	2,125	2,139	-	1,085,951
Asset/Liability Management and Local Corporate Centre	245	-	-	-	245
Total	**2,449,061**	**250,685**	**85,697**	**52,452**	**2,837,894**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2017					
Retail	614,193	92,268	14,414	57,739	778,615
Corporates	600,337	50,393	18,021	8,090	676,841
Group Markets	916,770	22	-	-	916,792
Asset/Liability Management and Local Corporate Centre	-	2,825	-	-	2,825
Total	**2,131,301**	**145,508**	**32,435**	**65,829**	**2,375,073**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2016					
Retail	487,849	101,610	18,301	70,947	678,707
Corporates	448,660	57,130	16,076	50,687	572,553
Group Markets	859,163	15,035	-	59	874,257
Asset/Liability Management and Local Corporate Centre	1	-	-	-	1
Total	**1,795,673**	**173,775**	**34,377**	**121,693**	**2,125,518**

Credit risk exposure by business segment and IFRS 9 treatment

in HUF million	Stage 1	Stage 2	Stage 3	POCI	Credit risk exposure (AC and FVOCI)	Subject to provision	Total
As of 31 December 2018							
Retail	727,885	32,708	24,628	26,346	811,567	41,255	852,823
Corporates	823,271	8,345	4,634	12,439	848,690	50,186	898,876
Group Markets	967,534	-	-	-	967,534	118,417	1,085,951
Asset/Liability Management and Local Corporate Centre	245	-	-	-	245	-	245
Total	**2,518,934**	**41,053**	**29,262**	**38,786**	**2,628,035**	**209,859**	**2,837,894**

Non-performing credit risk exposure and credit loss allowances

The non-performing exposure ratio (NPE ratio) is calculated as the non-performing credit risk exposure divided by total credit risk exposure while the NPE coverage ratio (excl. collateral) is computed as the credit loss allowances divided by non-performing credit risk exposure. Collateral or other recoveries are not taken into account.

Non-performing credit risk exposure by business segment and coverage by credit loss allowances

	Non-performing		Credit risk exposure		Credit loss allowances	Collateral for NPE		NPE ratio		NPE coverage (excl. collateral)		NPE collateralization ratio	
in HUF million	Total	AC and FVOCI	Total	AC and FVOCI	AC and FVOCI	Total	AC and FVOCI	Total	AC and FVOCI	Total	AC and FVOCI	Total	AC and FVOCI
As of 31 December 2018													
Retail	46,135	45,739	852,823	837,193	37,649	25,296	24,983	5.41%	5.46%	81.61%	82.31%	54.83%	54.62%
Corporates	6,842	6,837	898,876	892,605	6,556	2,770	2,765	0.76%	0.77%	95.83%	95.90%	40.49%	40.44%
Group Markets	-	-	1,085,951	969,155	286	-	-	0.00%	0.00%				
Asset/Liability Management and Local Corporate Centre	-	-	245	1,727	-	-	-	0.00%	0.00%				
Total	**52,977**	**52,576**	**2,837,894**	**2,700,681**	**44,491**	**28,066**	**27,748**	**1.87%**	**1.95%**	**83.98%**	**84.62%**	**52.98%**	**52.78%**

	Total credit risk exposure						
in HUF million	Non-performing	Total credit risk exposure	Total credit risk provisions	Specific allowances & provisions	Collective allowances & provisions	NPE ratio	NPE coverage ratio (excl. collateral)
As of 31 December 2017							
Retail	57,739	778,615	45,273	33,826	11,447	7.42%	78.41%
Corporates	8,090	676,841	15,661	4,449	11,212	1.20%	193.59%
Group Markets	-	916,792	11	-	11	0.00%	
Asset/Liability Management and Local Corporate Centre	-	2,825	116	-	116	0.00%	
Total	**65,829**	**2,375,073**	**61,062**	**38,274**	**22,787**	**2.77%**	**92.76%**

	Total credit risk exposure						
in HUF million	Non-performing	Total credit risk exposure	Total credit risk provisions	Specific allowances & provisions	Collective allowances & provisions	NPE ratio	NPE coverage ratio (excl. collateral)
As of 31 December 2016							
Retail	70,947	678,707	49,826	41,594	8,232	10.45%	70.23%
Corporates	50,687	572,553	50,244	41,032	9,211	8.85%	99.13%
Group Markets	59	874,257	4	- -	4	0.01%	7.03%
Asset/Liability Management and Local Corporate Centre	-	1	-	-	-	0.00%	
Total	**121,693**	**2,125,518**	**100,074**	**82,626**	**17,448**	**5.73%**	**82.23%**

.

Expected credit loss measurement

The general principles and standards for credit loss allowances are governed by internal policies in EBH. According to IFRS 9, credit loss allowances are calculated for all components of the credit risk exposure which are measured at amortised cost (AC) or at fair value through other comprehensive income and include other demand deposits, debt securities, loans and advances as well as finance lease and trade receivables. Provisions for loan commitments and financial guarantees are calculated if they meet the applicable IFRS 9 respective definitions.

According to the IFRS9 there are three main stages outlined for expected credit loss (ECL) determination:

- If financial instrument that is not credit-impaired on initial recognition is classified in Stage 1. Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 month.
- If a significant increase in credit risk (SICR) since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired. Instruments in Stage 2 have their ECL measured based on expected credit losses on a lifetime (LT) basis. If the financial instrument is credit impaired, the financial instrument is then moved to Stage 3. Instruments in Stage 3 have their ECL measured based on expected credit losses on a LT basis.
- Purchased or originated credit-impaired (POCI) financial instruments are those financial instruments that are credit-impaired on initial recognition. Their ECL is always measured on LT basis.

The key judgments and assumptions adopted by EBH in addressing the requirements of the standard are presented below:

Significant increase in credit risk determination

In the area of expected credit loss (ECL) modelling and calculation of ensuing credit loss allowances (CLA), EBH has concluded that one of the key drivers of the impact from applying the ECL model required by IFRS 9 is the assessment of significant increase in credit risk (SICR) for exposures that are not identified as credit-impaired as at the date of initial application of IFRS 9 (for retrospective application) or as at any given reporting period after transition to IFRS 9 (for prospective application). In this respect, across portfolios and product types, quantitative and qualitative indicators are defined for assessing SICR, including the indicator of 30 days-past-due (DPD).

Quantitative criteria

Quantitative SICR indicators include adverse changes in annualised lifetime probability of default and in life-time probability of default with significance being assessed by reference to a mix of relative and absolute change thresholds. In order to positively conclude on SICR for particular financial instrument, both relative and absolute thresholds need to be breached. Relative measure is calculated as ratio between current annualised PD and annualised PD value on initial recognition. These ratios are compared against limits set up as threshold for SICR assessment. Breach means that such ratio has reached or is higher than established threshold.

These relative thresholds for SICR assessment are established at PD segment level or client rating level for each entity, as necessary, and are subject to initial and on-going validation.

Absolute threshold refers to difference of LT PD on initial recognition and current LT PD. It is set to 50 bps and serves as back-stop for migrations between the best ratings. In such cases relative thresholds are being breaches however overall PD is very low, therefore SICR is not positively concluded.

	Threshold intervals		Sensitivity analysis			
			Threshold change +/- 0.5		Threshold change +/- 1	
in HUF million	Min	Max	ECL impact increase*	ECL impact decrease*	ECL impact increase	ECL impact decrease
2018						
Hungary	1.13	3.57	(301)	+321	(476)	+1045

Qualitative criteria

Qualitative SICR indicators include forbearance-type flags (identification of regulatory forbearance), work-out transfer flag (when account starts being monitored by work-out department), information from early-warning-system (if it is not sufficiently considered in rating) and fraud indicators. The assignment of some of the qualitative indicators inherently relies on experienced credit risk judgment being exercised adequately and timely. The related credit risk controlling policies and procedures (adapted as necessary in the light of transition to IFRS 9)

.

ensure the necessary governance framework. These indicators are used internally for identification of insolvency or increased probability that borrower will enter bankruptcy and there is increased risk of default in the foreseeable future. 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.

There are no cure periods established for qualitative criteria for migration back to Stage 1 other than those already established in general credit risk practice for the used above-mentioned flags (forbearance, watch lists).

Backstop
A backstop is applied and the financial instruments are considered to have experienced a SICR if the borrower is more than 30 days past due on contractual payments. It is observed during validation, that it does not represent major trigger for Stage 2 classification.

Measuring ECL – explanation of inputs and measurement

Collective allowances are calculated for exposures to non-defaulted customers according to a rule-based approach irrespective of the significance of the customer, except for credit loss allowances against in-scope debt securities issued by non-defaulted issuers, for which, in general, an individual calculation approach is applied.
The calculation of collective allowances requires grouping the related exposures into homogenous clusters on the basis of shared risk characteristics. The grouping criteria may differ on the customer segment (retail, corporate) and include product type, collateral type, repayment type, loan to value band or credit rating band.

The calculation of credit loss allowances is done on a monthly basis on single exposure level and in the contractual currency of the exposure. To compute the credit loss allowance, EBH applies an expected credit loss (ECL) model based on a three stages approach that either leads to a twelve-month ECL or to a lifetime ECL. ECL is discounted product of exposure at default (EAD) that includes as well credit conversion factor in case of off balance sheet exposures, probability of default (PD) and loss given default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per definition of default below), either over next 12 month (1Y PD) or over remaining lifetime (LT PD)
- EAD is based on the amounts EBH expects to be owed at the time of default, over next 12 months (1Y EAD) or over remaining lifetime (LT EAD). EBH includes to the estimation current balance, expected repayments and expected drawings up to the current contractual limit by the time of default, should it occur.
- LGD represents EBH's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit exposure at the time of default (EAD).

Life time parameters
LT PD is developed through observation of historical defaults from initial recognition through the life time of the loans. It is assumed to be same across all assets in the same portfolio and rating band.

1Y and LT EADs are determined based on the expected payment profiles, which vary by different product types. LT EAD calculation utilizes repayment schedule or repayment type (annuity, linear, bullet). In case of undrawn commitments, credit conversion factor is estimated for reflecting them properly in EAD.

LGD is estimated as a life-time curve for any point in time, based on the historical loss observations.

The risk parameters used in the ECL calculation take into account available information at the reporting date about past events, current conditions and forecasts on future economic trends. Generally, the risk parameters applied in the calculation of collective allowances may differ from the risk parameters compliant to capital requirement regulations if the characteristics of the respective portfolio in combination with IFRS standards necessitate this.

Incorporation of forward looking information
Parameters are determined to reflect the risk as a "point-in-time" measure and with consideration of forward-looking information ("FLI"), which resulted in introducing a baseline forecast and a number of alternative scenarios for selected macroeconomic variables. These are derived, together with their probabilities of occurrence, as a deviation from baseline forecasts. Given multiple scenarios, the "neutral" PDs

(and also LGDs, with a few exceptions) are adjusted through macro models which link relevant macroeconomic variables with risk drivers. Same macro-shift models as for external and internal stress test are employed. Forward looking information is incorporated for first three years of ECL measurement. Measurement of the remaining life time returns back to through the cycle observations in the year four immediately.

Thus, the unbiased, probability-weighted ECL is derived with the weights representing the occurrence probabilities 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 local market. Nevertheless, main indication of the estimated economic development can be predicted through GDP development.

GDP scenario analysis

	Scenario	Probability	2018	2019	2020	2021
	Upside	41%	4.7	4.6	3.8	3.8
Hungary	Baseline	50%	4.1	3.3	2.5	2.5
	Downside	9%	3.0	1.1	0.3	0.3

The three stages approach applies to financial instruments in the scope of the impairment requirements of IFRS 9 and which are not categorised as purchased or originated credit-impaired financial assets (POCI), which form a category on their own. Depending on the impairment status and the assessment of the development of credit risk, these financial instruments are assigned to one of three stages.

Classification into stages and definition of credit-impaired financial instruments

Stage 1 includes in-scope not credit-impaired financial instruments at initial recognition and not credit-impaired financial instruments without a significant increase in credit risk since initial recognition irrespective of their credit quality or subject to the "low risk exemption" allowed by IFRS 9. In Stage 1, the credit risk loss allowances are calculated as twelve-months ECL.

Stage 2 includes in-scope not credit-impaired financial instruments with a significant increase in credit risk since initial recognition and not subject to the "low credit risk exemption" allowed by IFRS 9, as well as any in-scope not credit-impaired exposures subject to the "simplified approach" (like the unit-linked portfolio) allowed or requested by IFRS 9. In stage 2, the credit risk loss allowances are calculated as lifetime ECL. In the case of drawings by non-defaulted customers on previously committed credit lines, depending on the development of credit risk between the commitment date and the drawing date, the whole exposure (on-balance and off-balance) is categorised as either Stage 1 or Stage 2.

Stage 3 includes in-scope financial instruments which are credit-impaired at the reporting date but were not credit-impaired at initial recognition. In principle, a financial instrument becomes credit-impaired when the customer defaults. The default definition applied in EBH has been developed in accordance with EBA/GL/2016/07 "Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 and MNB's 39/2016 regulation on non-performing loans and forbearance. The definition specifies the rules for default contagion across groups of connected clients and clarifies the concept of technical default. EBH applies a customer view in applying the default definition, which leads to an impairment of all claims even if the customer defaults only on one of several transactions ("pulling effect"). On the other side, an upgrade to a non-defaulted rating grade implies that the total exposure ceases to be impaired. In stage 3, the credit loss allowances are calculated as lifetime ECL.

POCI includes in-scope financial instruments which were credit-impaired at initial recognition, irrespective of whether they are still credit-impaired at the reporting date. Expected credit losses against POCI exposures are always calculated on a lifetime basis, but those attributable to POCI on-balance exposures for which lifetime expected recoveries remained constant or improved since initial recognition are not recognised as credit loss allowances distinct from the related gross carrying amounts.

Grouping of instruments

Credit loss allowances against Stage 3 or POCI exposures are calculated individually or collectively. The individual approach is applied in case of exposures to significant defaulted customers and consists of the individual assessment of the difference between the gross carrying amount and the net present value of the expected cash flows which are estimated by workout or risk managers. The discounting of the cash flows is based on the effective interest rate (POCI: credit-adjusted effective interest rate).

A defaulted customer is classified as individually significant if the total on- and off-balance exposure exceeds a predefined materiality limit. Otherwise, the customer is considered as insignificant and a rule-based approach is used for the calculation of the related credit loss allowance. Under this approach, credit loss allowances are calculated as the product of gross carrying amount and loss given default (LGD), where LGD depends on characteristics such as time in default or the stage of the workout process.

Composition of credit loss allowances

in HUF million	2017	2018
Specific allowances	38,083	-
Collective allowances	19,418	-
Credit loss allowances		42,101
Provisions for loan commitments and financial guarantees	3,560	2,470
Provisions for other commitments		659
Total	**61,062**	**45,230**

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.

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 and MNB regulation 39/2016. 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;
- the customer would be 30 days past due or more without receiving forbearance;
- the customer is in default;
- the modified contract was classified as non-performing or would be non-performing without forbearance;
- 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;
- 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 two years one of the following forbearance classifications is fulfilled:
- an additional forbearance measure is extended and in the past the customer was in the non-performing forbearance category;
- 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;
- the customer meets any of the default event criteria defined in the default definition;
- for corporate customers, when a final restructuring agreement cannot be concluded within 18 months after the first forbearance measure.

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 two 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);
- 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;
- the customer has repaid the full past due amount or the written-off amount (if there was any).
- corporate customer: 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 are 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 qualitative trigger events in the SICR concept according to the internal regulations of EBH.

Credit risk exposure, forbearance exposure and credit loss allowances

in HUF million	Loans and advances	Debt securities	Other balance-sheet positions	Loan commitments and financial guarantees	Total
As of 31 December 2018					
Gross exposure	**1,442,478**	**823,454**	**142,628**	**429,334**	**2,837,894**
thereof gross forborne exposure	14,243	1,083	-	42	15,368
Performing exposure	1,394,531	822,371	142,157	426,384	2,785,442
thereof performing forborne exposure	5,808	-	-	42	5,850
Credit loss allowances for performing exposure	9,819	136	317	1,140	11,411
thereof credit loss allowances for performing forborne exposure	170	-	-	-	171
Non-performing exposure	47,947	1,083	471	2,951	52,452
thereof non-performing forborne exposure	8,435	1,083	-	-	9,518
Credit loss allowances for non-performing exposure	30,741	627	592	1,120	33,080
thereof credit loss allowances for non-performing forborne exposure	4,323	627	-	-	4,949

in HUF million	Loans and receivables	Financial assets	Other balance-sheet positions	Contingent liabilities	Total
As of 31 December 2017					
Gross exposure	**1,299,306**	**754,840**	**21,026**	**299,902**	**2,375,073**
thereof gross forborne exposure	21,922	-	-	36	21,959
Performing exposure	1,235,368	754,840	21,026	297,751	2,308,985
thereof performing forborne exposure	9,734	-	-	36	9,770
Credit risk provisions for performing exposure	19,418	-	-	2,991	22,409
thereof credit risk provisions for performing forborne exposure	664	-	-	-	664
Non-performing exposure	63,938	-	-	2,150	66,088
thereof non-performing forborne exposure	12,189	-	-	1	12,189
Credit risk provisions for non-performing exposure	38,083	-	-	569	38,653
thereof credit risk provisions for non-performing forborne exposure	4,906	-	-	-	4,906

in HUF million	Loans and receivables	Financial assets	Other balance-sheet positions	Contingent liabilities	Total
As of 31 December 2016					
Gross exposure	**1,261,095**	**631,627**	**15,184**	**217,613**	**2,125,518**
thereof gross forborne exposure	44,023	-	-	-	44,023
Performing exposure	1,157,023	631,627	15,184	199,869	2,003,703
thereof performing forborne exposure	21,764	-	-	9	21,764
Credit risk provisions for performing exposure	16,244	-	-	950	17,194
thereof credit risk provisions for performing forborne exposure	2,927	-	-	-	2,927
Non-performing exposure	104,072	-	-	17,743	121,815
thereof non-performing forborne exposure	11,769	-	-	-	11,769
Credit risk provisions for non-performing exposure	62,166	-	-	20,715	82,880
thereof credit risk provisions for non-performing forborne exposure	11,769	-	-	-	11,769

.

Types of forbearance exposure

in HUF million	Gross forborne exposure	Modification in terms and conditions	Refinancing
As of 31 December 2018			
Loans and advances	14,248	14,005	243
Debt securities	1,083	1,083	-
Loan commitments and financial guarantees	42	42	-
Total	**15,373**	**15,130**	**243**

in HUF million	Gross forborne exposure	Modification in terms and conditions	Refinancing
As of 31 December 2017			
Loans and receivables	20,808	19,909	899
Financial assets	1,114	1,114	-
Total	**21,922**	**21,023**	**899**

in HUF million	Gross forborne exposure	Modification in terms and conditions	Refinancing
As of 31 December 2016			
Loans and receivables	42,698	33,125	9,573
Financial assets	1,326	1,326	-
Total	**44,023**	**34,450**	**9,573**

Loans and advances figures incudes lease, trade and other receivables

Credit quality of forbearance exposure by geographical segment

in HUF million	Gross forborne exposure	Neither past due nor credit impaired	Past due but not credit impaired	Credit impaired	Collateral	Credit loss allowances
As of 31 December 2018						
Central and Eastern Europe	**15,373**	**5,684**	**1,948**	**7,741**	**7,328**	**5,120**
Hungary	15,373	5,684	1,948	7,741	7,328	5,120
Total	**15,373**	**5,684**	**1,948**	**7,741**	**7,328**	**5,120**

in HUF million	Gross forborne exposure	Neither past due nor credit impaired	Past due but not credit impaired	Credit impaired	Collateral	Credit loss allowances
As of 31 December 2017						
Central and Eastern Europe	**21,922**	**11,377**	**2,370**	**8,175**	**13,406**	**5,570**
Hungary	21,922	11,377	2,370	8,175	13,406	5,570
Total	**21,922**	**11,377**	**2,370**	**8,175**	**13,406**	**5,570**

in HUF million	Gross forborne exposure	Neither past due nor credit impaired	Past due but not credit impaired	Credit impaired	Collateral	Credit loss allowances
As of 31 December 2016						
Central and Eastern Europe	**44,023**	**-**	**-**	**17,867**	**17,192**	**-**
Hungary	44,023	-	-	17,867	17,192	-
Total	**44,023**	**-**	**-**	**17,867**	**17,192**	**-**

.

Collaterals

Recognition of collateral

The Collateral Management department is a staff unit within the Corporate Risk Management. The EBH Collateral Management Policy defines, among other things, uniform valuation standards for credit collateral. It ensures that the credit risk decision processes are standardised with respect to accepted collateral values.

The valuation and revaluation of collateral is done according to the principles defined in the Group Collateral Catalogue broken down by collateral type and based on the internal work instructions in accordance with the individual supervisory requirements. Whether a type of collateral or a specific collateral asset is accepted for credit risk mitigation is decided by Enterprise-wide Risk Management after determining if the applicable regulatory requirements are met.
Credit underwriting monitors adherence to the standard work processes stipulated for assigning the acceptable collateral assets to the categories available.

Main types of collateral

The following types of collateral are accepted:

- real estate: residential and commercial real estate;
- financial collateral: securities, cash deposits and life insurance policies;
- guarantees: given by sovereigns, public sector entities, financial institutes, companies and individuals. All guarantors must have a minimum credit rating, which is reviewed annually;
- movables: equipment, investment goods, machineries and motor vehicles;
- claims and rights: account receivables of trade, leasehold rights and shares in a company's capital.

Protection by credit default swaps is only marginally used in the banking book.

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 valuation processes are defined and their IT-supported technical application is performed by Collateral Management at group level and by the Collateral Management Team in Hungary with the assistance of software applications. The allocated collateral values are capped by the amount of the secured transaction. Therefore, imputed excess collateral values are not possible. 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.

For quality assurance purposes, the real estate evaluation mechanism and real estate valuations itself are validated on an ongoing basis.

The methods and discounts used for valuations are based on empirical data representing past experience of the workout departments and on the collected data on recoveries from realising collateral. The valuation methods are adjusted regularly – at least once a year – to reflect current recoveries.

The revaluation of collateral is done periodically and is automated as far as possible. In the case of external data sources, the appropriate interfaces are used. The maximum periods for the revaluation of individual collateral assets are predefined and compliance is monitored by risk management using software applications. Apart from periodic revaluations, collateral is assessed when information becomes available that indicates a decrease in the value of the collateral for exceptional reasons.

Concentration risks resulting from credit risk mitigation techniques may affect a single customer, but also a portfolio defined by region, industry, or type of collateral. All guarantee liabilities and loans of a corporate guarantee provider are taken into consideration in the credit application process in order to prevent possible concentrations. Guarantees provided by sovereigns, a public sector entity or financial institutions have to lie within the approved limit of the guarantor. Concerning other areas of a potentially detrimental correlation of risks, the collateral portfolios are analysed using statistical evaluations for, among other things, regional or industry-specific concentrations within the scope of portfolio monitoring. The response to those risks identified includes, above all, the adjustment of volume targets, setting of corresponding limits and modification of the staff's discretionary limits for lending.

The following tables compare the credit risk exposure broken down by business and geographical segments to the allocated collateral. The amount of allocated collateral corresponds to the accepted value after internal haircuts capped by the exposure amount.

Credit risk exposure by business segment and collateral

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 2018						
Retail	852,823	425,453	15,627	388,724	21,101	427,370
Corporates	898,876	316,569	65,106	151,779	99,684	582,307
Group Markets	1,085,951	18,250	18,250	-	-	1,067,701
Asset/Liability Management and Local Corporate Centre	245	-	-	-	-	245
Total	**2,837,894**	**760,271**	**98,983**	**540,503**	**120,785**	**2,077,623**

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
Retail	778,615	392,420	2,795	376,306	13,319	386,194
Corporates	676,841	236,820	43,782	118,668	74,371	440,021
Group Markets	916,792	6,185	6,185	-	-	910,608
Asset/Liability Management and Local Corporate Centre	2,825	-	-	-	-	2,825
Total	**2,375,073**	**635,425**	**52,762**	**494,973**	**87,690**	**1,739,648**

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
Retail	678,707	402,094	2,485	391,256	8,352	276,614
Corporates	572,553	228,398	68,228	96,413	63,757	344,155
Group Markets	874,257	6,282	6,282	-	-	867,975
Asset/Liability Management and Local Corporate Centre	1	-	-	-	-	1
Total	**2,125,518**	**636,773**	**76,995**	**487,669**	**72,109**	**1,488,745**

Credit risk exposure by geographical segment and collateral

			Collateralised by			
in HUF million	Total credit risk exposure	Collateral total	Guarantees	Real estate	Other	Credit risk exposure net of collateral
As of 31 December 2018						
Central and Eastern Europe	**2,837,894**	**760,271**	**98,983**	**540,503**	**120,785**	**2,077,623**
Hungary	2,837,894	760,271	98,983	540,503	120,785	2,077,623
Total	**2,837,894**	**760,271**	**98,983**	**540,503**	**120,785**	**2,077,623**

			Collateralised by			
in HUF million	Total credit risk exposure	Collateral total	Guarantees	Real estate	Other	Credit risk exposure net of collateral
As of 31 December 2017						
Central and Eastern Europe	**2,375,073**	**635,425**	**52,762**	**494,973**	**87,690**	**1,739,648**
Hungary	2,375,073	635,425	52,762	494,973	87,690	1,739,648
Total	**2,375,073**	**635,425**	**52,762**	**494,973**	**87,690**	**1,739,648**

			Collateralised by			
in HUF million	Total credit risk exposure	Collateral total	Guarantees	Real estate	Other	Credit risk exposure net of collateral
As of 31 December 2016						
Central and Eastern Europe	**2,125,518**	**636,773**	**76,995**	**487,669**	**72,109**	**1,488,745**
Hungary	2,125,518	636,773	76,995	487,669	72,109	1,488,745
Total	**2,125,518**	**636,773**	**76,995**	**487,669**	**72,109**	**1,488,745**

Credit risk exposure by financial instrument and collateral

			Collateralised by						
in HUF million	Total credit risk exposure	Collateral total	Guarantees	Real estate	Other	Credit risk exposure net of collateral	Neither past due nor credit impaired	Past due but not credit impaired	Credit impaired
As of 31 December 2018									
Cash and cash balances - demand deposits to central banks and credit institutions	4,895	-	-	-	-	4,895	4,895	-	-
Derivatives and debt instruments held for trading	91,130	-	-	-	-	91,130	-	-	-
Non-trading debt instruments at FVPL	30,702	-	-	-	-	30,702	-	-	-
Debt instruments at FVOCI	134,035	-	-	-	-	134,035	134,035	-	-
Debt instruments at AC	658,717	45	-	45	-	658,672	657,634	-	1,083
Debt securities	914,584	45	-	45	-	914,539	791,669	-	1,083
Loans and advances to banks	95,692	-	-	-	-	95,692	95,685	7	-
Loans and advances to customers	1,294,466	637,150	41,452	521,679	74,018	657,316	1,148,181	59,397	45,156
Trade and other receivables	14,171	-	-	-	-	14,171	12,472	1,699	-
Finance lease receivables	38,149	28,138	-	2,682	25,455	10,012	36,450	1,225	474
Off balance-sheet exposures	475,937	94,938	57,530	16,097	21,312	380,999	412,465	14,228	2,949
out of which: other commitments	46,295	15,498	3,087	2,957	9,453	30,797	-	-	-
Total	**2,837,894**	**760,271**	**98,983**	**540,503**	**120,785**	**2,077,623**	**2,501,817**	**76,556**	**49,662**

.

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 credit impaired	Past due but not credit impaired	Credit 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	61,242	-	-	-	-	61,242	61,229	13	-
Loans and receivables to customers	1,237,033	589,348	21,415	486,507	81,425	647,685	1,107,555	71,280	58,198
Financial assets - held to maturity	575,440	-	-	-	-	575,440	575,440	-	-
Financial assets - held for trading	52,042	-	-	-	-	52,042	52,042	-	-
Financial assets - available for sale	127,357	-	-	-	-	127,357	127,357	-	-
Positive fair value of derivatives	21,026	-	-	-	-	21,026	21,026	-	-
Contingent liabilities	299,902	46,078	31,347	8,466	6,265	253,824	277,074	20,979	1,849
Total	**2,375,073**	**635,425**	**52,762**	**494,973**	**87,690**	**1,739,648**	**2,222,755**	**92,272**	**60,047**

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 credit impaired	Past due but not credit impaired	Credit impaired
As of 31 December 2016									
Cash and cash balances – other demand deposits	11,048	-	-	-	-	11,048	11,048	-	-
Loans and receivables to credit institutions	145,875	-	-	-	-	145,875	138,752	7,064	59
Loans and receivables to customers	1,104,172	565,772	15,673	482,706	67,393	538,399	940,033	66,051	98,087
Financial assets - held to maturity	395,338	-	-	-	-	395,338	395,338	-	-
Financial assets - held for trading	101,360	-	-	-	-	101,360	101,360	-	-
Financial assets - available for sale	134,929	-	-	-	-	134,929	134,929	-	-
Positive fair value of derivatives	15,371	-	-	-	-	15,371	15,315	-	56
Contingent liabilities	217,434	71,001	61,321	4,964	4,716	146,433	198,888	995	17,552
Total	**2,125,527**	**636,773**	**76,995**	**487,669**	**72,109**	**1,488,753**	**1,935,663**	**74,109**	**115,755**

Credit risk exposure neither past due nor credit impaired by financial instrument and risk category

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2018					
Cash and cash balances - demand deposits to central banks and credit institutions	4,895	-	-	-	4,895
Derivatives and debt instruments held for trading	90,930	65	135	-	91,130
Non-trading debt instruments at FVPL	62,412	7,019	1,048	146	70,625
Debt instruments at FVOCI	134,035	-	-	-	134,035
Debt instruments at AC	1,669,180	183,025	48,373	923	1,901,501
Debt securities	657,634	-	-	-	657,634
Loans and advances to banks	95,685	-	-	-	95,685
Loans and advances to customers	915,861	183,025	48,373	923	1,148,181
Trade and other receivables	10,327	1,413	732	-	12,472
Finance lease receivables	30,449	4,916	1,085	-	36,450
Off balance-sheet exposures	407,906	43,392	6,990	473	458,760
out of which: other commitments	40,583	4,166	1,074	471	46,295
Total	**2,410,133**	**239,829**	**58,364**	**1,541**	**2,709,867**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2017					
Cash and cash balances – other demand deposits	1,031	-	-	-	1,031
Loans and receivables to credit institutions	61,242	-	-	-	61,242
Loans and receivables to customers	1,009,652	131,435	32,008	63,938	1,237,033
Financial assets - held to maturity	575,440	-	-	-	575,440
Financial assets - held for trading	52,042	-	-	-	52,042
Financial assets - available for sale	127,357	-	-	-	127,357
Positive fair value of derivatives	20,700	314	11	-	21,026
Contingent liabilities	283,835	13,759	416	1,892	299,902
Total	**2,131,301**	**145,508**	**32,435**	**65,829**	**2,375,073**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2016					
Cash and cash balances – other demand deposits	11,048	-	-	-	11,048
Loans and receivables to credit institutions	131,149	14,666	-	59	145,875
Loans and receivables to customers	813,569	152,419	34,171	104,012	1,104,172
Financial assets - held to maturity	395,338	-	-	-	395,338
Financial assets - held for trading	101,360	-	-	-	101,360
Financial assets - available for sale	134,929	-	-	-	134,929
Positive fair value of derivatives	14,764	551	-	56	15,371
Contingent liabilities	193,524	6,139	206	17,565	217,434
Total	**1,795,682**	**173,775**	**34,377**	**121,693**	**2,125,527**

Credit risk exposure past due and not covered by credit loss allowances by financial instrument and collateralisation

	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 2018												
Debt instruments at AC	61,213	52,004	4,664	1,316	202	3,027	50,884	45,635	3,837	980	48	384
Loans and advances to banks	7	-	-	-	-	7	-	-	-	-	-	-
Loans and advances to customers	61,206	52,004	4,664	1,316	202	3,020	50,884	45,635	3,837	980	48	384
Trade and other receivables	1,699	1,633	66	-	-	-	-	-	-	-	-	-
Finance lease receivables	1,225	1,137	62	26	-	-	1,224	1,136	62	26	-	-
Off balance-sheet exposures	14,228	13,738	361	63	55	11	485	485	-	-	-	-
Total	**78,365**	**68,511**	**5,153**	**1,406**	**257**	**3,038**	**52,593**	**47,256**	**3,899**	**1,006**	**48**	**384**

in HUF million	Total credit risk exposure 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	Thereof collateralised 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 2017												
Loans and receivables to credit institutions	13	0	-	-	-	13	-	-	-	-	-	-
Loans and receivables to customers	71,280	57,036	5,561	2,196	189	6,297	30,275	26,402	2,743	672	35	423
Contingent liabilities	20,979	20,588	289	36	40	25	-	-	-	-	-	-
Total	**92,272**	**77,624**	**5,850**	**2,233**	**229**	**6,336**	**30,275**	**26,402**	**2,743**	**672**	**35**	**423**

in HUF million	Total credit risk exposure 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	Thereof collateralised 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												
Loans and receivables to credit institutions	7,064	7,043	-	-	-	21	-	-	-	-	-	-
Loans and receivables to customers	67,046	49,168	7,567	2,207	299	7,805	31,115	25,662	4,051	1,107	41	253
Total	**74,109**	**56,211**	**7,567**	**2,207**	**299**	**7,826**	**31,115**	**25,662**	**4,051**	**1,107**	**41**	**253**

All claims presented in the table above were classified as non-performing if they were more than 90 days past due. “Stage 3” credit loss allowances are, as a rule, established for assets that are more than 90 days past due. However, allowances are not established if the related loans and advances are covered by adequate collateral.

Loans and advances to customers

The tables on the following pages present the structure of the customer loan book, excluding loans to central banks and credit institutions broken-down by different categories. Loans and advances to customers comprise

- loans to customers at FVPL;
- loans and advances to customers at AC;;
- finance lease receivables;
- trade and other receivables.

On the next pages loans and advances to customers are presented by:

- business segment and risk category;
- business segment and IFRS 9 treatment;
- business segment and coverage of non-performing loans to customers by loan loss allowances;
- business segment and coverage by loan loss allowances and IFRS 9 treatment;
- geographical segment and coverage of non-performing loans to customers by loan loss allowances;
- geographical segment and coverage by loan loss allowances and IFRS 9 treatment;
- business segment and currency;
- geographical segment and currency.

Loans and advances to customers by business segment and risk category

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2018					
Retail	466,997	156,584	53,753	44,037	721,370
Corporates	523,880	50,042	24,633	3,910	602,465
Group Markets	22,705	-	-	-	22,705
Asset/Liability Management and Local Corporate Centre	245	-	-	-	245
Total	**1,013,826**	**206,626**	**78,386**	**47,947**	**1,346,785**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2017					
Retail	516,483	87,235	14,018	55,951	673,687
Corporates	426,477	44,199	17,989	7,987	496,652
Group Markets	66,692	1	-	-	66,693
Total	**1,009,652**	**131,435**	**32,008**	**63,938**	**1,237,033**

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2016					
Retail	461,816	98,855	18,127	70,087	648,885
Corporates	303,476	53,367	16,044	33,925	406,812
Group Markets	48,268	197	-	-	48,465
Asset/Liability Management and Local Corporate Centre	1	-	-	-	1
Total	**813,561**	**152,419**	**34,171**	**104,012**	**1,104,163**

.

Loans and advances to customers by business segment and IFRS 9 treatment

in HUF million	Stage 1	Stage 2	Stage 3	POCI	Gross customer loans (AC)	Subject to provision	Total
As of 31 December 2018							
Retail	599,616	31,351	23,317	26,036	680,320	41,050	721,370
Corporates	579,944	7,269	2,429	12,141	601,784	681	602,465
Group Markets	22,705	-	-	-	22,705	-	22,705
Asset/Liability Management and Local Corporate Centre	245	-	-	-	245	-	245
Total	**1,202,510**	**38,620**	**25,746**	**38,177**	**1,305,053**	**41,732**	**1,346,785**

Stage 1 and Stage 2 comprise not credit impaired loans and advances while Stage 3 includes credit impaired loans and advances. POCI (purchased or originated credit impaired) consists of loans already credit impaired when purchased or originated.

In the following tables, the non-performing loans and advances to customers divided by reporting segment are contrasted with allowances for customer loans and the collateral for non-performing loans (NPL). The NPL ratio, the NPL coverage ratio (excl. collateral), and the NPL collateralization ratio are also included.

Non-performing loans and advances to customers by business segment and coverage by loan loss allowances

in HUF million	Non-performing		Gross customer loans		Loan loss allowances	Collateral for NPL		NPL ratio		NPL coverage (exc. collateral)	NPL collateralisation ratio	
	Total	AC	Total	AC	AC	Total	AC	Total	AC	AC	Total	AC
As of 31 December 2018												
Retail	44,037	43,640	721,370	680,320	(35,854)	25,184	24,871	6.1%	6.4%	82.2%	57.2%	57.0%
Corporates	3,910	3,906	602,465	601,784	(4,620)	2,377	2,372	0.6%	0.6%	118.3%	60.8%	60.7%
Group Markets	-	-	22,705	22,705	(22)	-	-	0.0%	0.0%			
Asset/Liability Management and Local Corporate Centre	-	-	245	245	-	-	-	0.0%	0.0%			
Total	**47,947**	**47,546**	**1,346,785**	**1,305,053**	**(40,496)**	**27,561**	**27,243**	**3.6%**	**3.6%**	**85.2%**	**57.5%**	**57.3%**

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	55,951	673,687	43,199	33,737	9,462	8.31%	77.21%	33,876	137.75%
Corporates	7,987	496,652	14,298	4,346	9,953	1.61%	179.03%	3,746	225.94%
Group Markets	-	66,693	4	-	4	0.00%		-	
Asset/Liability Management and Local Corporate Centre	-	-	-	-	-	0.00%		-	
Total	**63,938**	**1,237,033**	**57,501**	**38,083**	**19,418**	**5.17%**	**89.93%**	**37,622**	**148.77%**

.

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	70,087	648,885	48,845	41,307	7,538	10.80%	69.69%	4543741%	135%
Corporates	33,925	406,812	29,561	20,859	8,702	8.34%	87.14%	936159%	115%
Group Markets	-	48,465	4	-	4	0.00%	6750838.17%	0%	6750838%
Asset/Liability Management and Local Corporate Centre	-	1	-	-	-	0.00%		0%	
Total	**104,012**	**1,104,163**	**78,410**	**62,165**	**16,244**	**9.42%**	**75.38%**	**54,799**	**128.07%**

Total gross customer loans, total non-performing loans, and total collateral include both AC and FVPL portfolios.

Loans and advances to customers at AC and coverage by loan loss allowances by business segment and IFRS 9 treatment

in HUF million	Loans to customers				Loan loss allowances						
	Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI	Stage 2 coverage ratio	Stage 3 coverage ratio	POCI coverage ratio
As of 31 December 2018											
Retail	599 616	31 351	23 317	26 036	3 085	4 701	17 506	10 561	15.00%	75.08%	40.56%
Corporates	579 944	7 269	2 429	12 141	1 644	436	2 000	540	6.00%	82.35%	4.45%
Group Markets	22,705	-	-	-	22	-	-	-			
Asset/Liability Management and Local Corporate Centre	245	-	-	-	-	-	-	-			
Total	**1 202 510**	**38 620**	**25 746**	**38 177**	**4 751**	**5 137**	**19 507**	**11 101**	**13.30%**	**75.77%**	**29.08%**

Total gross customer loans, total non-performing loans, and total collateral include both AC and FVPL portfolios.

The NPL ratio of loans and advances to customers is calculated by dividing the gross carrying amount of non-performing loans and advances to customers by the total gross carrying amount of loans and advances to customers. Consequently, it differs from the NPE ratio in section "Credit risk exposure". Collaterals for non-performing loans mainly consist of real estates.

The NPL coverage ratio (excluding collateral) is calculated by dividing total loss allowances by the gross carrying amount of the non-performing loans and advances to customers. Collateral or other recoveries are not taken into account.

Loans and advances to customers at AC and coverage by loan loss allowances by geographical segment and IFRS 9 treatment

in HUF million	Loans to customers				Loan loss allowances						
	Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI	Stage 2 coverage ratio	Stage 3 coverage ratio	POCI coverage ratio
As of 31 December 2018											
Central and Eastern Europe	**1,202,510**	**38,620**	**25,746**	**38,177**	**4,751**	**5,137**	**19,507**	**11,101**	**13.30%**	**75.77%**	**29.08%**
Hungary	1,202,510	38,620	25,746	38,177	4,751	5,137	19,507	11,101	13.30%	75.77%	29.08%
Total	**1,202,510**	**38,620**	**25,746**	**38,177**	**4,751**	**5,137**	**19,507**	**11,101**	**13.30%**	**75.77%**	**29.08%**

The above presented NPL exposures are exclusive of any write-offs recognised in accordance with IFRS 9. EBH distinguishes between contractual write-offs (debt forgiveness towards the defaulted client, either unconditional or subject to conditions) and technical write-offs (claim removal from the books due to no reasonable expectation of recovery, whereby the legal claim towards the customer still remains), however it didn't have any technical write-offs in 2018. Both types of write-offs have as pre-condition that all reasonable workout measures and late collections tools have been applied for optimal recovery. In case of collateralised loans, write-off prior to the realization of the collateral is not allowed unless specific circumstances apply. Additional technical write-off triggers include enforcement, worthlessness of claim/collateral, legally binding bankruptcy/liquidation or other economic loss of the rights to claim, sale.

Loans and advances to customers by business segment and currency

in HUF million	EUR	CEE-local currencies	CHF	USD	Other	Total
As of 31 December 2018						
Retail	2,909	718,051	377	26	7	721,370
Corporates	332,430	260,074	9,920	41	-	602,465
Group Markets	2,104	20,600	-	-	-	22,705
Asset/Liability Management and Local Corporate Centre	245	-	-	-	-	245
Total	**337,688**	**998,726**	**10,297**	**66**	**7**	**1,346,785**

in HUF million	EUR	CEE-local currencies	CHF	USD	Other	Total
As of 31 December 2017						
Retail	1,417	671,625	596	40	9	673,687
Corporates	274,659	205,648	16,302	43	-	496,652
Group Markets	2,725	63,968	-	-	-	66,693
Total	**278,801**	**941,241**	**16,898**	**82**	**9**	**1,237,033**

in HUF million	EUR	CEE-local currencies	CHF	USD	Other	Total
As of 31 December 2016						
Retail	1,142	646,354	1,335	44	9	648,885
Corporates	205,460	175,356	24,541	1,455	1	406,812
Group Markets	3,075	39,853	-	5,537	-	48,465
Asset/Liability Management and Local Corporate Centre	-	-	1	-	-	1
Total	**209,677**	**861,563**	**25,877**	**7,036**	**10**	**1,104,163**

Loans and advances to customers by geographical segment and currency

in HUF million	EUR	CEE-local currencies	CHF	USD	Other	Total
As of 31 December 2018						
Central and Eastern Europe	**337,688**	**998,726**	**10,297**	**66**	**7**	**1,346,785**
Hungary	337,688	998,726	10,297	66	7	1,346,785
Total	**337,688**	**998,726**	**10,297**	**66**	**7**	**1,346,785**

in HUF million	EUR	CEE-local currencies	CHF	USD	Other	Total
As of 31 December 2017						
Central and Eastern Europe	**278,801**	**941,241**	**16,898**	**82**	**9**	**1,237,033**
Hungary	278,801	941,241	16,898	82	9	1,237,033
Total	**278,801**	**941,241**	**16,898**	**82**	**9**	**1,237,033**

in HUF million	EUR	CEE-local currencies	CHF	USD	Other	Total
As of 31 December 2016						
Central and Eastern Europe	**209,677**	**861,563**	**25,877**	**7,036**	**10**	**1,104,163**
Hungary	209,677	861,563	25,877	7,036	10	1,104,163
Total	**209,677**	**861,563**	**25,877**	**7,036**	**10**	**1,104,163**

44.4 Market risk

Market risk is the risk of loss that may arise due to adverse changes in market prices and to the parameters derived from them. These market value changes might appear in the profit and loss account, in the statement of comprehensive income or in hidden reserves. At Erste Bank, market risk is divided into interest rate risk; credit spread risk, currency risk, equity risk, commodity risk and volatility risk. This concerns both trading and banking book positions. Commodity risk had no effect on Erste Bank Hungary's financial position as it had no relevant positions.

Methods and instruments employed

At Erste Bank, potential losses that may arise from market movements are assessed using the value at risk (VaR). For the VaR calculations Erste Bank follows the group wide methodology of Erste Group. The calculation is done according to the method of historic simulation with a one-sided confidence level of 99%, a holding period of one day and a simulation period of two years. The VaR describes what level of losses may be expected as a maximum at a defined probability – the confidence level – within a certain holding period of the positions under historically observed 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 materialised. At a confidence level of 99%, the actual loss on a single day should exceed the VaR statistically only two to three times a year (1% of around 250 workdays).

This shows one of the limits of the VaR approach: on the one hand, the confidence level is limited to 99%, and on the other hand, the model takes into account only those market scenarios observed in each case within the simulation period of two years, and calculates the VaR for the current position of the bank on this basis. In order to investigate any extreme market situations beyond this, stress tests are conducted. These events include mainly market movements of low probability.

The stress tests are carried out according to several methods: stressed VaR (SVaR) is derived from the normal VaR calculation. But instead of simulating only over the two most recent years, an analysis of a much longer period is carried out in order to identify a one-year period that constitutes a relevant period of stress for the current portfolio mix. According to the legal framework, that one-year period is used to calculate a VaR with a 99% confidence level. This enables Erste Bank on the one hand to hold sufficient own funds available for the trading book even in periods of elevated market volatility, while on the other hand also enabling it to incorporate these resulting effects into the management of trading positions. The results of the VaR and SVaR calculations are used for the calculation of the Pilar 2 capital requirement for the Trading Book.
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 Liquidity and Market Risk Department on a daily basis.

Methods and instruments of risk mitigation

Based on the group wide methodology of Erste Group, market risks are controlled in the trading book by setting several layers of limits. The overall limit on the basis of VaR for the trading book is allocated in the Risk Appetite Statement while taking into account the risk-bearing capacity and projected earnings.

All market risk activities of the trading book are assigned to risk limits that are statistically consistent in their entirety with the overall VaR limit and applied as a second limit layer to the VaR limits.

The VaR is calculated every day and made available to the trading unit as well as to the Management.

Banking book positions are subjected to a monthly analysis. In this manner, the total VaR is determined with exactly the same methodology as for the trading book.

Analysis of market risk

The following tables show the VaR amounts at the 99% confidence level using equally weighted market data and with a holding period
of one day:

Value at Risk of the banking book and the trading book

in HUF million	Total	Interest	Currency	Shares
As of 31 December 2018				
Erste Bank Hungary	1 010	979	44	-
Banking book	969	969	-	-
Trading book	42	10	44	-

As of 31 December 2017				
Erste Bank Hungary	627	622	11	-
Banking book	566	566	-	-
Trading book	61	56	11	-

Interest rate risk in the banking book

Interest rate risk is the risk of an adverse change in the fair value of financial instruments caused by a movement in market interest rates. This type of risk arises when mismatches exist between assets and liabilities, including derivatives, 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 on the balance sheet, are grouped into maturity bands based on their remaining terms to maturity or terms to an interest rate adjustment. Positions without a fixed maturity (e.g. demand deposits) are included on the basis of modelled deposit rates that are determined by means of statistical methods.

The following tables list the open interest rate positions held by Erste Bank in the four currencies that carry a significant interest rate risk: HUF, EUR, USD and CHF.

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

Interest rate risk positions not assigned to the trading book

Open fixed-income positions not assigned to the trading book

in HUF million	0-3 months	3-6 months	6-12 months	over 1 year
As of 31 December 2018				
Repricing gap in HUF positions	(530,122)	79,340	70,007	565,455
Repricing gap in EUR positions	(106,097)	(28,263)	17,517	11,846
Repricing gap in USD positions	(52,384)	19,977	(1,930)	3,312
Repricing gap in CHF positions	(2,456)	194	7,483	(756)

Open fixed-income positions not assigned to the trading book

in HUF million	0-3 months	3-6 months	6-12 months	over 1 year
As of 31 December 2017				
Repricing gap in HUF positions	(365,481)	112,918	30,260	367,430
Repricing gap in EUR positions	(165,411)	2,868	15,732	14,344
Repricing gap in USD positions	(23,913)	(1,519)	17,524	(870)
Repricing gap in CHF positions	12,611	1,749	7,262	(1,076)

.

Credit spread risk
Credit spread risk is the risk of an adverse movement in the fair value of financial instruments caused by a change in the creditworthiness of an issuer perceived by the market. Erste Bank is exposed to credit spread risk with respect to its securities portfolio, both in the trading and in the banking book.

For the trading book, credit spread risk for government bonds is part of the general market risk covered by VaR and SVaR. Corporate bonds are allocated to benchmark spread curves depending on sector, rating, and currency as part of the general risk covered by VaR and SVaR.
The quantification of the credit spread risk of the securities in the banking book is based on a historical simulation. The maximum (hypothetical) drawdown that can be attributed to credit related risk factors over one-year horizon is calculated. It is based on credit spread sensitivities (CR01) and the risk factors used are asset swap spreads.

Exchange rate risk
The bank is exposed to several types of risks related to exchange rates. These concern risks from open foreign exchange positions and others.

Risk from open foreign exchange positions is the risk related to exchange rates 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 a daily basis. Foreign currency exposure is subject to regulatory and internal limits. The internal limits are set by the Asset Liability Committee.

The following table shows the largest consolidated open foreign currency positions of Erste Bank Hungary as of 31 December 2018 and the corresponding open positions of these currencies as of 31 December 2017.

Open foreign currency positions

in HUF million	Dec 17	Dec 18
Swiss Franc (CHF)	(843)	60
Euro (EUR)	(6,897)	1,830
Japanese Yen (JPY)	7	(9)
US Dollar (USD)	138	559
Other	9	67

44.5 Liquidity risk
The liquidity risk in Erste Bank is defined in line with the principles set out by the Basel Committee on Banking Supervision as well as the European and Hungarian regulations (Capital Regulations Requirement (CRR) - Regulation (EU) No 575/2013, Delegated Regulation (EU) 2015/61, Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (Hpt.)) and MNB recommendations. Accordingly, a distinction is made between market liquidity risk, which is the risk that the bank entities cannot easily offset or close 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 and on time in an economically justified manner, while structural liquidity risk is the long-term risk of losses due to a change in the institution's own refinancing cost or spread.

Liquidity strategy

In 2018, client deposits remained the primary source of funding for Erste Bank: the volume of client deposits increased to HUF 1 650 billion as of year-end 2018 (2017: HUF 1 480 billion), amounting to 67% (2017: 69%) of the balance sheet total. Due to the fact that client deposits inflows was approximately equal with the growth of loan production, the loan-to-deposit ratio has not changed and remained at the level of 79% (2017: 79%).

Liquidity ratios

With the implementation of the CRR at the beginning of 2014, new liquidity ratios, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) have been introduced as ratios relevant for reporting purposes. The LCR represents a ratio of highly liquid assets vis-à-vis net cash outflows over a 30 day time horizon. The required minimum of the ratio was 100% in 2018. The NSFR remains for the time being a reporting requirement only, with a binding minimum requirement potentially introduced from 2019. The NSFR represents a ratio of available stable funding vis-à-vis required stable funding within a 12 month time horizon. In addition to the European regulation there are local liquidity indicators that Erste Bank has to comply with: DMM- Foreign Funding Adequacy Ratio, DEM - Foreign Currency Equilibrium Ratio, JMM - Mortgage Funding Adequacy Ratio and Wholesale Funding Ratio.

Methods and instruments employed

Short-term insolvency risk is monitored by calculating the survival period (SPA). This analysis determines the maximum period during which the entity can survive a set of defined scenarios, including a severe combined market and idiosyncratic crisis while relying on its pool of liquid assets. The monitored worst-case scenario simulates very limited money market and capital market access and at the same time significant client deposit outflows. Furthermore, the simulation assumes increased drawdown on guarantees and loan commitments dependent on the type of customer, as well as the potential outflows from collateralised derivative transactions estimating the effect of collateral outflows in the case of adverse market movements. To reflect the reputational risk from callable own issues, the principal outflows from these liabilities are modelled to the next call date in all stress scenarios. Starting with 2018, an updated version of the survival period analysis came into force. It contained, among other improvements, an extension of the stress horizon up to 12 months, dependent on the stress scenario.

Additionally, the traditional liquidity gaps (depicting the going concern maturity mismatches) are reported and monitored regularly. Concentration risks in the “Counterbalancing Capacity” (CBS), in terms of funds and assets are regularly monitored and reported to the regulator. Erste Bank’s funds transfer pricing (FTP) system has also proven to be an efficient 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 Bank.
Short-term liquidity risk is managed by limits resulting from the survival period model, internal stress testing and by internal LCR targets. Liquidity indicators are reported to the Operative Liquidity Committee (OLC) and the Asset Liability Committee (ALCO). Another important instrument for managing the liquidity risk within Erste Bank is the FTP system.

Analysis of liquidity risk

In Erste Bank, the liquidity risk is analysed by the following methods.

Liquidity coverage ratio

Erste Bank uses the regulatory liquidity coverage ratio according the delegated regulation (EU) 2015/61 (LCR according LCR DA) for internal monitoring and steering of the liquidity position as well. In order to keep the LCR according LCR DA above both limits,

.

the regulatory limit and the internal limit, Erste Bank closely monitors its short-term liquidity inflows and outflows as well as its available counterbalancing capacity.

The following table shows the LCR DA as of 31 December 2018:

Liquidity coverage ratio

in HUF million	Dec 17	Dec 18
Liquidity buffer	714,164	759,680
Net liquidity outflow	372,248	387,273
Liquidity coverage ratio	**192%**	**196%**

Liquidity gaps

The long-term liquidity position is managed through using liquidity gaps on the basis of expected cash flows. This liquidity position is calculated for each material currency and based on the assumption of ordinary business activity. Fulfilment of the internal and regulatory liquidity risk requirements as well as the current and expected market environment is also taken into account.

Expected cash flows are broken down by contractual maturities in accordance with the amortisation schedule and arranged in maturity ranges. All cash-flows derived from products without contractual maturities (such as demand deposits and overdrafts) are classified based on internal behavioural models.

The following table shows the liquidity gaps as of 31 December 2018 and 31 December 2017:

Liquidity gap

	Dec 17					Dec 18			
in HUF million	**< 1 month**	**1-12 months**	**1-5 years**	**> 5 years**		**< 1 month**	**1-12 months**	**1-5 years**	**> 5 years**
On-Balance Sheet Liquidity GAP	(174,818)	56,117	254,550	(135,848)	,	-221,704,	(136,095),	566,166,	(208,367),
Off-Balance Sheet Liquidity GAP	326	1,405	3,458	2,581	,	2,102,	(1,031),	1,577,	4,202,

An excess of assets over liabilities is indicated by a positive value, while an excess of liabilities over assets is indicated by a negative value. The liquid security portfolio concentrated on the 1-5 years tenor is represented according to its original maturity profile, although it can be mobilised at any time to cover the negative gaps on the short-term tenors.

Counterbalancing capacity

Erste Bank regularly monitors its counterbalancing capacity, which consists of cash, excess minimum reserves at the central banks as well as unencumbered central bank eligible assets and other liquid securities, including impacts from repos and reverse repos. These assets can be mobilised in the short term to offset potential cash outflows in a crisis situation. The term structure of the counterbalancing capacity as of year-end 2018 and year-end 2017 are shown in the tables below:

Term structure of counterbalancing capacity

in HUF million	< 1 week	1 week-1 month	1-3 months	3-6 months	6-12 months
December 2018					
Cash, excess reserve	21,952	-	-	-	-
Liquid assets	803,947	(9,443)	(8,572)	(58,768)	(65,699)
Counterbalancing capacity	**825,899**	**(9,443)**	**(8,572)**	**(58,768)**	**(65,699)**
December 2017					
Cash, excess reserve	20,292	-	-	-	-
Liquid assets	672,738	-	(35,191)	(52,621)	(8,129)
Counterbalancing capacity	**693,030**	**-**	**(35,191)**	**(52,621)**	**(8,129)**

.

The figures above show the total amount of potential liquidity available for the group in a going concern situation, taking into account the applicable central bank haircuts. In a crisis situation, adverse market movements and legal transfer restrictions among group members can decrease this amount. Taking into account these effects, the initial counterbalancing capacity available at group level is reduced by additional haircuts and liquidity transfer constraints. Negative figures are maturing positions of the counterbalancing capacity. Positive figures after 1 week are positions not immediately available as counterbalancing capacity.

Financial liabilities

Maturities of contractual undiscounted cash flows from financial liabilities as of 31 December 2018 and 31 December 2017 respectively, were as follows:

Financial liabilities

in HUF million	Carrying amount	Contractual cash flows	< 1 month	1-12 months	1-5 years	> 5 years
As of 31 December 2018						
Non-derivative liabilities	**2,052,164**	**2,090,276**	**375,870**	**554,719**	**567,664**	**592,024**
Financial liabilities at FVPL	**-**	**-**	**-**	**-**	**-**	**-**
Financial liabilities at AC	**2,052,164**	**2,090,276**	**375,870**	**554,719**	**567,664**	**592,024**
Deposits by banks	339,127	364,496	133,666	27,815	90,770	112,244
Customer deposits	1,649,231	1,650,518	239,645	523,096	464,420	423,356
Debt securities in issue	4,164	4,450	-	1,040	2,995	415
Other financial liabilities	2,823	2,823	2,558	49	102	114
Subordinated liabilities	56,819	67,990	-	2,718	9,377	55,895
Derivative liabilities	**19,839**	**19,839**	**2,753**	**10,342**	**3,341**	**3,404**
Total	**2,072,003**	**2,110,116**	**378,622**	**565,060**	**571,005**	**595,428**
	,	,	,	,	,	,
As of 31 December 2017	**,**	**,**	**,**	**,**	**,**	**,**
Non-derivative liabilities	**1,765,614**	**1,791,664**	**282,277**	**358,134**	**652,429**	**498,823**
Financial liabilities at FVPL	**-**	**-**	**-**	**-**	**-**	**-**
Financial liabilities at AC	**1,765,614**	**1,791,664**	**282,277**	**358,134**	**652,429**	**498,823**
Deposits by banks	228,982	239,475	56,530	36,527	69,440	76,977
Customer deposits	1,479,116	1,481,022	224,966	317,532	573,304	365,220
Debt securities in issue	6,836	7,187	781	1,956	1,038	3,412
Other financial liabilities	-	-	-	-	-	-
Subordinated liabilities	50,681	63,980	-	2119	8647	53,214
Derivative liabilities	**15,807**	**15,807**	**3,239**	**6,678**	**4,207**	**1,682**
Total	**1,781,421**	**1,807,470**	**285,516**	**364,813**	**656,636**	**500,506**

As of 1 January 2017

Non-derivative liabilities	**1,685,431**	**1,704,330**	**1,167,258**	**252,018**	**204,899**	**80,155**
Financial liabilities at FVPL	**-**	**-**	**-**	**-**	**-**	**-**
Financial liabilities at AC	**1,685,431**	**1,704,330**	**1,167,258**	**252,018**	**204,899**	**80,155**
Deposits by banks	229,413	234,547	46,882	41,966	83,841	61,857
Customer deposits	1,389,515	1,392,674	1,118,013	200,385	59,472	14,804
Debt securities in issue	15,904	16,615	2,363	7,560	3,198	3,494
Other financial liabilities	-	-	-	-	-	-
Subordinated liabilities	50,599	60,494	-	2106	58,388	-
Derivative liabilities	**11,590**	**11,590**	**2,745**	**4,670**	**1,989**	**2,186**
Total	**1,697,021**	**1,715,920**	**1,170,003**	**256,688**	**206,888**	**82,342**

As of year-end 2018, the currency composition of the non-derivative liabilities consisted of approximately 75.84% HUF, 19.84% EUR, 3.60% USD, and 0.72% in other currencies (2017: 72,30% HUF, 21,07% EUR, 5,54% USD, 1,09% in other currencies).

As of 31 December 2018, the volume of customer deposits due on demand amounted to HUF 1 368 billion (2017: HUF 1 280 billion). According to customer segments, the customer deposits are composed as follows: 57% private individuals, 13% large corporates, 27% small and medium-sized enterprises, 2% public sector, (2017: 63% private individuals, 18% large corporates, 14% small and medium-sized enterprises, 5% public sector,).The deposits by banks include the top five providers of funds.

44.6 Operational risk

In line with Article 4 Section 52 of regulation (EU) 575/2013 (CRR), Erste Group defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal risks. Both quantitative and qualitative methods are used to identify operational risks. Consistent with international practice, the responsibility for managing operational risk rests with the line management.

Methods and instruments employed

The quantitative measurement methods are based on internal loss experience data, which are collected across Erste Group using a standard methodology and entered into a central data pool. Additionally, in order to be able to model losses that have not occurred in the past but are nonetheless possible, scenarios and external data are also used. Erste Group sources external data from a leading non-profit risk-loss data consortium.

Erste Group calculates capital requirements for operational risk based on the Advanced Measurement Approach (AMA) that is subject to regulatory approval. AMA is a sophisticated approach for measuring 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. Additionally, Erste Group received the approval to use insurance contracts for mitigation within the AMA pursuant to Article 323 CRR.

In order to update the underlying methodology, Erste Group applied for, and during Q3-18 received regulatory approval for a material AMA model change that is applicable as of Q4/2018. As a result of this change, Erste Group has strengthened the capabilities for quantifying its operational risk profile. Changes include inter alia

- update of statistical methodology in order to increase stability and alignment with the Group's risk profile;
- implementation of P&L view to ensure consistency with overall bank reporting;
- longer observation period for the internal loss data to increase the statistical validity of the model's underlying data;
- more risk-sensitive capital allocation key to legal entities covered in the AMA model.

Methods and instruments of risk mitigation

In addition to quantitative methods, qualitative methods are also used to determine operational risk, such as risk and control assessments through expert panels. Additional methods include setting of key risk indicators and risk assessments in connection with product approvals, outsourcing assessments and risk return decisions. The results of these assessments and processes are reported to line management along with mitigation measures and thus help to reduce operational risks. In order to ensure early detection of changes in the risk profile which may lead to losses, Erste Group monitors a number of key risk indicators such as: system availability, staff turnover, or customer complaints.

Erste Group uses a group-wide insurance program which has reduced the cost of meeting Erste Group's traditional property insurance needs. Resources thus released made it possible to buy additional insurance for previously uninsured bank-specific risks. This program uses a captive reinsurance entity as a vehicle to share losses within the group and access the external market.

The quantitative and qualitative methods used, together with the insurance strategy and the modelling approaches described above, form the operational risk framework of Erste Group. Information on operational risk is periodically communicated to the management board via various reports, including the quarterly top management reports, which describe the recent loss history, loss development, qualitative information from risk assessments and key risk indicators as well as the operational VaR for Erste Group.

45) Fair value of financial instruments

Financial instruments carried at fair value

The measurement of fair value at Erste Bank is based primarily on external sources of data. Financial instruments for which the fair value is determined on the basis of quoted market prices are mainly listed securities and derivatives as well as liquid OTC bonds.

Description of valuation models and parameters

Erste Bank uses valuation models that have been tested internally and for which the valuation parameters (such as interest rates, exchange rates, volatilities and credit spreads) have been determined independently.

Loans. IFRS 9 regulation significantly changed accounting classification of loans. Not SPPI (solely payments of principal and interest) compliant loans are valued at fair value. The methodology to compute fair value of these loans corresponds to the basic present value technique where expected cash flows of assets are discounted by the full rate including risk premium required for non-market risk based part of the interest rate to be compliant with fair value definition. The credit risk is recognised by adjusting contractual cash flows to come to expected cash flows accounting for customer's probability of default and loss given default. These adjusted cash flows are then discounted by effective discount rate incorporating other risk/cost components.

Securities. For plain vanilla (fixed and floating rate) debt securities the fair value is calculated by discounting the future cash flows using a discounting curve depending on the interest rate for the respective issuance currency and a spread adjustment. The spread adjustment is usually derived from the credit spread curve of the issuer. If no issuer curve is available the spread is derived from a proxy instrument and adjusted for differences in the risk profile of the instruments. If no close proxy is available, the spread adjustment is estimated using other information, including estimation of the credit spread based on internal ratings and PDs or management judgment. For more complex debt securities (e.g. including option-like features such as callable, cap/floor, index-linked) the fair value is determined using combinations of discounted cash flow models and more sophisticated modelling techniques including methods described for OTC-derivatives.

Non-trading equity instruments which have quoted market prices in an active market are valued by using the quoted market price. For other investments in non-trading equity instruments the fair value is determined by standard valuation models using also unobservable input parameters.

The fair value of financial liabilities designated at fair value through profit or loss under the fair value option consist of mortgage bonds issued by Erste Mortgage Bank. The FV of these instruments are calculated on the basis of the quoted price of the government bond with the same maturity and the spread on mortgage bonds over the government bond yields.

OTC-derivative financial instruments. Derivative instruments traded in liquid markets (e.g. interest rate swaps and options, foreign exchange forward and options) are valued by using standard valuation models. Models are calibrated on quoted market data (including implied volatilities). For instruments in less liquid markets, data obtained from less frequent transactions or extrapolation techniques are used.

Credit value adjustments (CVA) for counterparty risk and debit value adjustments (DVA) for own default credit risk are applied to OTC derivatives. For the CVA the adjustment is driven by the expected positive exposure of all derivatives and the credit quality of the counterparty. DVA is driven by the expected negative exposure and Erste Group's credit quality. Erste Group has implemented an approach, where the modelling of the expected exposure is based on option replication strategies. For products where an option replication is not feasible the exposure is computed with Monte-Carlo simulation techniques. One of the two modelling approaches is considered for the most relevant portfolios and products. The methodology for the remaining entities and products is determined by market value plus add-on considerations. The probability of default by counterparties that are not traded in an active market is determined from internal PDs mapped to a basket of liquid titles present in the central European market. Market based valuation concepts are incorporated for this. Erste Group's probability of default has been derived from the buy-back levels of Erste Group's issuances. For counterparties with CSA-agreements in place no CVA was taken into account for all cases with immaterial threshold amounts.

Validation and control

The responsibility for valuation of financial instruments measured at fair value is independent of the trading units.

Fair value hierarchy

Financial assets and financial liabilities measured at fair value are categorised under the three levels of the IFRS fair value hierarchy.

Level 1 of the fair value hierarchy

The fair value of financial instruments assigned to Level 1 of the fair value hierarchy is determined based on quoted prices in active markets for identical financial assets and liabilities. More particular, the evaluated fair value can qualify as Level 1 if transactions occur with sufficient frequency, volume and pricing consistency on an ongoing basis.

These include exchange traded derivatives (futures, options), shares, government bonds as well as other bonds and funds, which are traded in highly liquid and active markets.

Level 2 of the fair value hierarchy

In case a market quote is used for valuation but due to restricted liquidity the market does not qualify as active (derived from available market liquidity indicators) the instrument is classified as Level 2. If no market prices are available the fair value is measured by using valuation models which are based on observable market data. If all the significant inputs in the valuation model are observable the instrument is classified as Level 2 of the fair value hierarchy. For Level 2 valuations typically yield curves, credit spreads and implied volatilities are used as observable market parameters.

These include OTC derivatives, less liquid shares, bonds and funds.

Level 3 of the fair value hierarchy

In some cases, the fair value can be determined neither on the basis of sufficiently frequent quoted market prices nor on the basis of valuation models that rely entirely on observable market data. In these cases individual valuation parameters which are not observable in the market are estimated on the basis of reasonable assumptions. If any unobservable input in the valuation model is significant or the price quote used is updated infrequently the instrument is classified as Level 3 of the fair value hierarchy. For Level 3 valuations besides observable parameters typically credit spreads derived from internally calculated historical probability of default (PD) and loss given default (LGD) measures are used as unobservable parameters.

Classification of financial instruments carried at fair value by levels of the fair value hierarchy

	31.12.2017				31.12.2018			
in HUF million	**Level 1**	**Level 2**	**Level 3**	**Total**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets								
Financial assets HfT	13,049	60,019	-	73,068	2,030	87,373	1,727	91,130
Derivatives	71	20,955	-	21,026	-	24,203	1,727	25,930
Other financial assets held for trading	12,978	39,064	-	52,042	2,030	63,171	-	65,201
Financial assets designated at FVPL	-	-	-	-	30,702	-	-	30,702
Non-trading financial assets at FVPL	x	x	x	x	-	-	42,870	42,870
Equity instruments	x	x	x	x	-	-	1,138	1,138
Loans and advances	x	x	x	x	-	-	41,732	41,732
Financial assets AfS	107,650	8,024	13,015	128,688	x	x	x	x
Equity instruments	-	-	1,331	1,331	x	x	x	x
Debt securities	107,650	8,024	11,684	127,357	x	x	x	x
Financial assets at FVOCI	x	x	x	x	102,687	32,881	1,483	137,052
Equity instruments	x	x	x	x	-	-	1,483	1,483
Debt securities	x	x	x	x	102,687	32,881	-	135,569
Loans and advances	x	x	x	x	-	-	-	-
Total assets	**120,699**	**68,042**	**13,015**	**201,756**	**135,419**	**120,255**	**46,080**	**301,754**
	,	,	,	,	,	,	,	,
Liabilities	,	,	,	,	,	,	,	,
Financial liabilities HfT	8	15,798	-	15,807	9	18,950	881	19,839
Derivatives	8	15,798	-	15,807	9	18,950	881	19,839
Total liabilities	**8**	**15,798**	**-**	**15,807**	**9**	**18,950**	**881**	**19,839**

The allocation of the appropriate level of positions is determined at the end of the reporting period.

Valuation process for financial instruments categorised as Level 3

The valuation of financial instruments categorised as Level 3 involves one or more significant inputs that are not directly observable on the market. Additional price verification steps need to be done. These may include reviewing relevant historical data and benchmarking for similar transactions, among others. This involves estimation and expert judgment.

Development of fair value of financial instruments in Level 3

in HUF million		Gains/losses profit or loss	Gains/losses OCI	Pur-chases	Sales	Settle-ments	Transfer into Level 3	Transfer out of Level 3	Currency transla-tion	
	01.01.2018									31.12.2018
Assets										
Financial assets HfT	-	-	-	-	-	-	1,727	-	-	1,727
Derivatives	-	-	-	-	-	-	1,727	-	-	1,727
Non-trading financial assets at FVPL	49,644	2,519	-	556	-	-9,848	-	-	-	42,870
Equity instruments	970	169	-	-	-	-	-	-	-	1,138
Loans and advances	48,674	2,350	-	556	-	-9,848	-	-	-	41,732
Financial assets at FVOCI	12,873	-	263	-	-	-	-	-11,684	31	1,483
Equity instruments	1,189	-	263	-	-	-	-	-	31	1,483
Debt securities	11,684	-	-	-	-	-	-	-11,684	-	-
Total assets	**62,516**	**2,519**	**263**	**556**	**-**	**(9,848)**	**1,727**	**-11,684**	**31**	**46,080**
	,	,	,	,	,	,	,	,	,	,
Liabilities	,	,	,	,	,	,	,	,	,	,
Financial liabilities HfT	-	-	-	-	-	-	881	-	-	881
Derivatives	-	-	-	-	-	-	881	-	-	881
Total liabilities	**-**	**-**	**-**	**-**	**-**	**-**	**881**	**-**	**-**	**881**

in HUF million		Gains/losses profit or loss	Gains/losses OCI	Pur-chases	Sales	Settle-ments	Transfer into Level 3	Transfer out of Level 3	Currency transla-tion	
	01.01.2017									31.12.2017
Assets	,	,	,	,	,	,	,	,	,	,
Financial assets HfT	1,620	(68)	-	-	-	-	-	(1,531)	(21)	-
Derivatives	1,620	(68)	-	-	-	-	-	(1,531)	(21)	-
Financial assets AfS	2,041	(19)	3,769	-	-	(4,847)	12,154	-	(83)	13,015
Total assets	**3,662**	**(87)**	**3,769**	**-**	**-**	**(4,847)**	**12,154**	**(1,531)**	**(104)**	**13,015**
	,	,	,	,	,	,	,	,	,	,
Liabilities	,	,	,	,	,	,	,	,	,	,
Financial liabilities HfT	-	(5)	-	-	-	-	-	5	-	-
Derivatives	-	(5)	-	-	-	-	-	5	-	-
Total liabilities	**-**	**(5)**	**-**	**-**	**-**	**-**	**-**	**5**	**-**	**-**

The volume of Level 3 financial assets can be allocated to the following categories:

_ Market values of derivatives where the credit value adjustment (CVA) has a material impact and is calculated based on unobservable parameters (i.e. internal estimates of PDs and LGDs).

_ Illiquid bonds, shares and funds not quoted in an active market where either valuation models with non-observable parameters have been used (e.g. credit spreads) or broker quotes have been used that cannot be allocated to Level 1 or Level 2.

_ Loans which do not comply with the contractual cash flow criteria.

Unobservable inputs and sensitivity analysis for Level 3 measurements

In case the fair value measurement of a financial asset is retrieved from input parameters which are not observable in the market, those parameters can be retrieved from a range of alternative parameters. For the preparation of the balance sheet the parameters where chosen to reflect the market situation at the reporting date.

Range of unobservable valuation parameters used in Level 3 measurements

Financial assets	Type of instrument	Fair value in HUF million	Valuation technique	Significant unobservable inputs	Range of unobservable inputs (weighted average)
Dec 18					
Positive fair value of derivatives	Forwards, swaps, options	-	Discounted cash flow and option models with CVA adjustment based on potential future exposure	PD	2,6%-3,8%
				LGD	60%
Financial assets at FVPL	Fixed and variable coupon bonds	-	Discounted cash flow	Credit Spread	na
	Loans	-	Discounted cash flow	PD	0.26%-100% (5.45%)
				LGD	7.39%-94% (11%)

Sensitivity analysis using reasonably possible alternatives per product type

in HUF million	dec.18 Fair value changes Positive	Negative
Derivatives	42	(46)
Income statement	42	(46)
Other comprehensive income	-	-
Debt securities	-	-
Income statement	-	-
Other comprehensive income	-	-
Equity instruments	258	(258)
Income statement	114	(114)
Other comprehensive income	144	(144)
Loans and advances	848	(6,176)
Income statement	848	(6,176)
Other comprehensive income	-	-
Total	**1,147**	**(6,480)**
Income statement	**1,004**	**(6,336)**
Other comprehensive income	**144**	**(144)**

In estimating these impacts, mainly changes in PDs, LGDs (for CVA of derivatives). An increase (decrease) of PDs and LGDs result in a decrease (increase) of the corresponding fair values. Positive correlation effects between PDs and LGDs were not taken into account in the sensitivity analysis. For non-trading equity instruments increases (decreases) in any of the inputs used for the cost of equity calculation in isolation would result in a lower (higher) fair value.

The following ranges of reasonably possible alternatives of the unobservable inputs were considered in the sensitivity analysis table:

_ for debt securities range of credit spreads between +100 basis points and -75 basis points
_ for equity related instruments the price range between -10% and +5%
_ for unquoted equity instruments the price range between -10% and +10%
_ for CVA on derivatives PDs rating upgrade/downgrade by one notch, as well as the change of LGD by -5% and +10%.
_ for loans, the PDs rating upgrade/downgrade by 1%, the change of LGD by -5% and +10% and a range of credit spreads between +100 basis points and -75 basis points

.

Financial instruments not carried at fair value with fair value disclosed in the notes

Dec 18 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	**1,993,299**	**1,997,535**	**615,821**	**75,880**	**1,305,833**
Cash and balances with central bank	26,845	26,845	26,845	-	-
Debt securities - at amortised cost with credit institutions	32,456	32,587	-	32,587	-
Debt securities - at amortised cost with customers	625,525	632,726	588,976	43,293	457
Loans and advances with credit institutions	95,630	95,687	-	-,	95,687
Loans and advances with customers	1,212,843	1,209,689	-	-,	1,209,689
LIABILITIES	**2,049,341**	**2,040,158**	**-**	**8,052**	**2,032,106**
Deposits from banks (not subordinated)	339,127	340,922	-	-	340,922
Deposits from customers	1,649,231	1,640,034	-	-	1,640,034
Debt securities issued	8,471	8,877	-	8,052	824
Subordinated liabilities	52,512	50,325	-	-	50,325

2017 Dec 17	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	**1,834,249**	**1,887,488**	**586,070**	**33,168**	**1,268,251**
Cash and balances with central bank	21,323	21,323	21,323	-	-
Loans and receivables to credit institutions	61,242	61,412	-	-	61,412
Loans and receivables to customers	1,176,243	1,206,839	-	-	1,206,839
Financial assets - held to maturity	575,440	597,914	564,747	33,168	-
	,	,	,	,	,
LIABILITIES	**1,765,614,**	**1,760,078**	**-**	**2,027**	**1,758,051**
Deposits from banks	228,996,	223,417	-	-	223,417
Deposits from customers	1,479,116,	1,479,925	-	-	1,479,925
Debt securities issued	6,836,	7,332	-	2,027	5,305
Subordinated liabilities	50,666,	49,403	-	-	49,403

The fair value of loans and advances to customers and credit institutions has been calculated by discounting future cash flows while taking into consideration interest and credit spread effects. The interest rate impact is based on the movements of market rates, while credit spread changes are derived from PDs and LGDs used for internal risk calculations. For the calculation of fair value loans and advances were grouped into homogeneous portfolios based on rating method, rating grade, maturity and the country where they were granted.

The fair values of debt securities at amortised cost are either taken directly from the market or they are determined by directly observable input parameters (i.e. yield curves).

The fair value of deposits and other liabilities, measured at amortised cost, is estimated by taking into account the current interest rate environment, as well as the own credit spreads. These positions are assigned to the Level 3 category. For liabilities without contractual maturities (e.g. demand deposits), the carrying amount represents the minimum of their fair value.

The fair value of issued securities and subordinated liabilities measured at amortised cost is based on market prices or on observable market parameters, if these are available. For issued securities where the fair value cannot be retrieved from quoted market prices, the fair value is calculated by discounting the future cash flows. The spread adjustment for Erste Bank's own credit risk is derived from buy-back levels of own issuances.

.

2018 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 presented in the Statement of Financial Position		**63**	**63**	**-**	**-**	**63**
Assets held for sale (IFRS 5)	31	30	30	-	-	30
Repossessed assets (IAS 2)	32	63	63	-	-	63

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 presented in the Statement of Financial Position		**99**	**99**	**-**	**-**	**99**
Repossessed assets (IAS 2)	32	99	99	-	-	99

46) Audit fees and consultancy fees

The following table contains audit and other fees charged by the auditors, PwC in the fiscal years 2017 and 2018:

in HUF million	2017	2018
	149	136

The total balance charged for 2017 consists of 133 million forint for audit fees and 16 million forint for other services (gross amounts, value-added tax included).

The total balance charged for 2018 consists of 126 million forint for audit fees and 10 million forint for other services (gross amounts, value-added tax included).

Other services consists of pre-takeover mortgage loan review and IFRS transition related services. Legal act prescribes that mortgage loans to be taken over by a mortgage bank (in this case subsidiary) are subject to an audit review as a kind of a guarantee for the quality at takeover.

47) Contingent liabilities

To meet the financial needs of customers, Erste Bank 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	2017	2018
Irrevocable contingent liabilities	**299,933**	**314,874**
Guarantees	31,710	308
Committed credit lines -irrevocable	265,686	268,271
Import accreditives and guarantees not having the character of credit substi-tutes	2,536	46,295
Revocable contingent liabilities	**98,188**	**134,476**
Committed credit lines - revocable	98,188	134,476
Other contingent liabilities	**3,800**	**3,688**
Legal cases	2,409	1,506
Other	1,391	2,182
Total	**401,920**	**453,038**

Related Provision see note 34, page 70.

Legal proceedings

Erste Bank 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 was somewhat increased by the Hungarian local courts initiating the preliminary ruling of European Court of Justice (“ECJ”) in several proceedings (4 cases against EBH). 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. Rulings of the ECJ adopted so far are in favour of strengthening the legal position represented by EBH in these lawsuits, as all of the judgements adopted by the ECJ so far confirmed the validity of the Hungarian legislation and judicial practice from a consumer protection perspective. As a result of these pending procedures, numerous other pending lawsuits have been suspended, the majority of which are still yet to be continued despite the fact that the ECJ has already adopted numerous preliminary rulings.

48) Analysis of remaining maturities

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

	Jan 17		Dec 17		Dec 18	
in HUF million	< 1 year	> 1 year	< 1 year	> 1 year	< 1 year	> 1 year
Cash and cash balances	106,049	-	21,323	-	26,845	-
Financial assets HfT	75,955	40,776	23,910	49,157	75,314	15,817
Financial assets at FVPL	x	x	x	x	4,401	69,171
Equity instruments	x	x	x	x	-	1,138
Debt securities	x	x	x	x	-	30,702
Loans and advances to customers	x	x	x	x	4,401	37,331
Financial assets - available-for-sale	5,975	131,774	13,449	116,067	x	x
Financial assets at FVOCI	x	x	x	x	-	137,052
Equity instruments	x	x	x	x	-	1,483
Debt securities	x	x	x	x	-	135,569
Financial assets - held to maturity	46,615	348,723	98,507	476,933	x	x
Loans and receivables to credit institutions	145,875	0	61,242	0	x	x
Loans and receivables to customers	260,056	765,706	308,164	871,367	x	x
Financial assets at AC	x	x	x	x	444,765	1,521,689
Debt securities	x	x	x	x	84,279	573,702
Loans and advances to banks	x	x	x	x	93,569	2,060
Loans and advances to customers	x	x	x	x	266,916	945,927
Finance lease receivables	x	x	x	x	20,683	16,919
Property and equipment	-	8,657	-	8,340	-	8,321
Investment properties	-	-	-	-	-	-
Intangible assets	-	15,666	-	22,315	-	21,153
Investments in associates and joint ventures	-	53,297	-	54,261	-	54,567
Current tax assets	636	-	628	-	1,380	-
Deferred tax assets	-	-	-	-	3,321	-
Assets held for sale	-	-	-	-	30	-
Trade and other receivables	-	-	-	-	13,000	1,114
Other assets	15,201	527	18,167	14	23,159	63
Total Assets	**656,363**	**1,365,126**	**545,390**	**1,598,455**	**612,867**	**1,845,896**
Financial liabilities HfT	7,415	4,176	9,918	5,889	13,094	6,745
Financial liabilities at FVPL	-	-	-	-	-	-
Debt securities issued	-	-	-	-	-	-
Financial liabilities at AC	693,755	991,676	635,393	1,130,222	924,662	1,127,502
Deposits from banks	87,831	192,181	91,153	188,509	158,424	233,215
Deposits from customers	596,364	793,151	541,618	937,498	762,192	887,039
Debt securities issued	9,559	6,345	2,621	4,215	1,439	7,032
Other financial liabilities	-	-	-	-	2,607	216
Provisions	21,329	3,755	4,609	4,019	1,744	5,526
Current tax liabilities	238	-	-	-	-	-
Deferred tax liabilities	-	-	564	-	-	-
Other liabilities	28,769	51	13,609	13,609	31,165	-
Total equity	-	270,328	-	326,015	-	348,324
Total Liabilities	**751,504**	**1,269,986**	**664,092**	**1,479,753**	**970,665**	**1,488,097**

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

The primary objectives of the Erste Bank's capital management policy are to ensure that Erste Bank 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 Bank 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 Bank 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 IFRS. IFRS 9 transition had no adverse impact on Erste Hungary's capital.

During 2018 and 2017 Erste Bank had complied in full with all its externally imposed capital requirements.

in HUF million	2017	2018
Tier 1 capital before deductions	326,015	348,324
Deductions from the Tier 1 capital (-)	67,460	49,518
Tier 1 capital after deductions	**258,554**	**298,806**
Tier 2 capital	52,676	54,362
Deductions from the Tier 2 capital (-)	-	-
Total qualifying own funds	**311,230**	**353,167**
Risk weighted assets (base for credit risk)	1,224,125	1,276,985
Capital requirement for credit risk	**97,930**	**102,159**
thereof IRB approach	87,763	92,305
thereof standardised approach	10,167	9,854
Capital requirement for market risk	**1,466**	**824**
thereof calculated with simple approach	1,466	824
thereof from debt instruments	1,466	824
Other capital requirements for credit valuation adjustment	**658**	**727**
Capital requirement for operational risk	**33,118**	**39,529**
Total base for capital requirement	**1,664,640**	**1,790,490**
Total capital requirement	**133,171**	**143,239**

50) Events after the balance sheet date

The proposed dividend to be presented at the Annual general meeting is amounting to 20 billion forint.

51) Other information

Erste Bank's signing representatives for financial statements of business year 2018:

Name	Address
Radován Jelasity	1026 Budapest, Balogh Ádám utca 35
Ivan Vondra	1051 Budapest, Dorottya utca 6

Responsible for preparation of the financial statements:
János Rádi (mother's maiden name: Mária Kmetty)
Registration number: 168198, certificate number: 009310, registration expertise: IFRS, finance

52) Details of the companies wholly or partly-owned by Erste Bank at 31 December 2018 and 2017 respectively

Company name	Interest of Erste Bank in % - directly or indirectly at 31.12.2017	Interest of Erste Bank in % - directly or indirectly at 31.12.2018
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%
Collat-reál Kft.	100%	100%
Erste Jelzálogbank Zrt.	100%	100%
Other investments:		
Union Vienna Insurance Group Zrt.	5.00%	1.36%
Budapest Stock Exchange Ltd.	2.30%	2.32%
Garantiqa Hitelgarancia Zrt.	2.10%	2.17%
Kisvállalkozás-fejlesztési Pénzügyi Zrt.	1.10%	1.13%
VISA Incorporated	0.0005%	0.0005%

in HUF million	Subscribed capital 2016	Subscribed capital 2017	Subscribed capital 2018
Subsidiaries:			
Erste Befektetési Zrt.	2,000	2,000	2,000
Erste Lakáslízing Zrt.	53	53	50
Erste Ingatlan Kft.	210	210	170
Sió Ingatlan Invest Kft.	12.9	12.9	12.9
Erste Lakástakarék Zrt.	2,025	2,025	2,025
Collat-reál Kft.	3	8	8
Erste Jelzálogbank Zrt.	3,000	3,005	3,010

The registered office of all of the subsidiaries is 24-26. Népfürdő utca, 1138 Budapest, Hungary.

.