

Erste Bank Hungary Zrt.

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

Consolidated Financial Statements 2018 (IFRS)

Consolidated Financial Statements 2018 (IFRS)	2
I. Consolidated Income Statement for the year ended 31 December 2018	4
II. Consolidated Statement of Comprehensive Income for the year ended 31 December 2018	5
III. Consolidated Statement of Financial Position at 31 December 2018	6
IV. Consolidated Statement of Changes in Equity	8
V. Consolidated Statement of Cash Flows	9
VI. Notes to the Consolidated Financial Statements	11
A. GENERAL INFORMATION	11
B. ACQUISITIONS, mergers AND DISPOSALS	12
C. MAJOR CHANGES IN LEGAL ENVIRONMENT OF FINANCIAL INSTITUTIONS	12
D. ACCOUNTING POLICIES	12
E. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	44
1) Net interest income	44
2) Net fee and commission income	45
3) Dividend income	45
4) Net trading result	45
5) Gains/losses from financial instruments measured at fair value through profit or loss	46
6) Rental income from investment properties & other operating leases	46
7) General administrative expenses	46
8) Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	47
9) Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss	47
10) Net impairment loss on financial assets	47
11) Impairment result from financial instruments	48
12) Other operating result	48
13) Taxes on income	49
14) Cash and cash balances	50
15) Derivatives – held for trading	51
16) Other financial assets held for trading	51
17) Non-trading financial assets at fair value through profit or loss	52
18) Financial assets - available for sale	52
19) Financial assets at fair value through other comprehensive income	52
20) Financial assets – held to maturity	53
21) Securities	54
22) Loans and receivables to credit institutions	54
23) Loans and receivables to customers	55
24) Financial assets at amortised cost	56
25) Loans and advances to banks at amortised cost	57
26) Loans and advances to customers at amortised cost	58
27) Finance lease receivables	60
28) Trade and other receivables	61
29) Debt instrument subject to contractual modifications	62
30) Fixed assets movement	62
31) Tax assets and liabilities	64
32) Assets held for sale	65
33) Other assets	65
34) Other financial liabilities held for trading	65
35) Financial liabilities at fair value through profit or loss	65
36) Financial liabilities at amortised costs	66
37) Provisions	69
38) Other liabilities	70
39) Total equity	71
40) Segment reporting	72
41) Assets and liabilities denominated in foreign currencies	75
42) Leases	76
43) Related party transactions	77
44) Collateral	82

45) Transfers of financial assets – repurchase transactions and securities lending.....	83
46) Offsetting of financial instruments	84
47) Risk management	85
48) Fair value of financial and non-financial instruments.....	128
49) Audit fees and consultancy fees.....	134
50) Contingent liabilities.....	135
51) Analysis of remaining maturities	136
52) Own funds and capital requirement according to Hungarian regulatory requirements	137
53) Events after the balance sheet date	138
54) Other information	138
55) Details of the companies wholly or partly-owned by Erste Bank Hungary Zrt. at 31 December 2017 and 2018 respectively.....	138


I. Consolidated Income Statement for the year ended 31 December 2018

in HUF million	Notes	2017	2018
Net interest income	1)	66,156	68,738
Interest income		71,077	70,452
Other similar income		5,955	10,644
Interest expenses		(8,423)	(7,513)
Other similar expenses		(2,453)	(4,845)
Net fee and commission income	2)	48,683	54,289
Fee and commission income		65,184	69,745
Fee and commission expenses		(16,501)	(15,456)
Dividend income	3)	81	37
Net trading result	4)	10,974	16,066
Foreign exchange transactions		11,655	(3,630)
Other		(681)	19,696
Gains/losses from financial instruments measured at fair value through profit or loss	5)	(793)	(1,568)
Rental income from investment properties & other operating leases	6)	1,180	1,220
Personnel expenses	7)	(31,243)	(30,061)
Other administrative expenses	7)	(27,517)	(26,777)
Depreciation and amortisation	7)	(9,509)	(10,919)
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	8)	5,753	x
Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss	9)	x	343
Net impairment loss on financial assets	10)	2,804	x
Impairment result from financial instruments	11)	x	6,780
Other operating result	12)	(6,535)	(16,834)
Other operating income	12)	38,523	8,459
Other operating expense	12)	(45,058)	(25,293)
Pre-tax result from continuing operations		60,034	61,314
Taxes on income	13)	(5,280)	(2,806)
Net result for the period		54,754	58,508
Net result attributable to owners of the parent		54,754	58,508

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

in HUF million	Notes	2017	2018
Net result for the period		54,754	58,508
Other comprehensive income			
Items that may not be reclassified to profit or loss			
Fair value reserve of equity instruments		x	263
Own credit risk reserve		x	(1)
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)		3,586	x
Gain/loss during the period		3,586	x
Fair value reserve of debt instruments		x	(4,409)
Gain/loss during the period		x	(4,074)
Reclassification adjustments		x	(335)
Cash flow hedge reserve	page 31	221	-
Reclassification adjustments		221	-
Deferred taxes relating to items that may be reclassified		(299)	343
Gain/loss during the period		(299)	344
Reclassification adjustments		-	(1)
Total other comprehensive income (loss)		3,509	(3,828)
Total comprehensive income		58,262	54,680
Total comprehensive income attributable to owners of the parent		58,262	54,680

Date: Budapest, 4 April 2019


Radován Jelasity
Chairman and CEO



Ivan Vondra
Chief Financial Officer

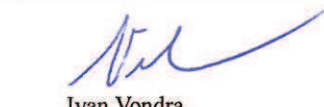
III. Consolidated Statement of Financial Position at 31 December 2018

in HUF million	Notes	2017	2018
Assets			
Cash and cash balances	14)	21,324	55,819
Financial assets held for trading		143,705	120,645
Derivatives	15)	21,083	25,982
Other financial assets held for trading	16)	122,622	94,663
Pledged as collateral	44)	1,682	-
Non-trading financial assets at fair value through profit or loss	17)	x	73,572
Equity instruments		x	1,138
Debt securities		x	30,702
Loans and advances to customers		x	41,732
Financial assets available for sale	18)	136,765	x
Pledged as collateral	44)	15,094	x
Financial assets at fair value through other comprehensive income	19)	x	149,648
Pledged as collateral		x	11,264
Equity instruments		x	1,483
Debt securities		x	148,165
Financial assets held to maturity	20)	651,900	x
Pledged as collateral	44)	51,949	x
Loans and receivables to credit institutions	22)	68,672	x
Pledged as collateral	44)	4,085	x
Loans and receivables to customers	23)	1,123,697	x
Pledged as collateral	44)	274,568	x
Financial assets at amortised cost	24)	x	2,031,071
Pledged as collateral	44)	x	249,526
Debt securities		x	736,784
Loans and advances to banks		x	97,777
Loans and advances to customers		x	1,196,510
Finance lease receivables	27)	x	37,602
Property and equipment	30)	8,600	8,624
Investment properties	30)	10,347	10,838
Intangible assets	30)	25,565	24,053
Current tax assets	31)	704	1,490
Deferred tax assets	31)	-	3,362
Assets held for sale	32)	1	1,405
Trade and other receivables	28)	x	14,113
Other assets	33)	27,791	31,265
Total assets		2,219,069	2,563,507

in HUF million	Notes	2017	2018
Liabilities and equity			
Financial liabilities held for trading		15,162	19,362
Derivatives	15)	15,092	18,740
Other financial liabilities held for trading	34)	70	622
Financial liabilities at fair value through profit or loss	35)	37,584	36,945
Debt securities issued	35)	37,584	36,945
Financial liabilities at amortised cost	36)	1,787,542	2,105,712
Deposits from banks		202,560	268,877
Deposits from customers		1,540,898	1,730,468
Debt securities issued		44,083	103,544
Other financial liabilities		-	2,823
Provisions	37)	8,691	7,293
Current tax liabilities	31)	-	46
Deferred tax liabilities	31)	584	167
Other liabilities	38)	30,228	36,118
Total equity	39)	339,278	357,864
Equity attributable to owners of the parent		339,278	357,864
Subscribed capital		146,000	146,000
Additional paid-in capital		117,492	117,492
Retained earnings and other reserves		75,786	94,372
Total liabilities and equity		2,219,069	2,563,507

Date: Budapest, 4 April 2019


Radován Jelasity
Chairman and CEO


Ivan Vondra
Chief Financial Officer

IV. Consolidated 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	Attributable to owners of the parent	Total equity
Total equity at 01 January 2018	39)	146,000	117,492	69,910	6,430	-	(555)	339,278	339,278
Changes of initial application of IFRS 9		-	-	3,977	(6,430)	6,316	44	3,807	3,907
Restated as of 1 January 2018		146,000	117,492	73,887	-	6,316	(511)	343,185	343,185
Dividends				(40,000)				(40,000)	(40,000)
Total comprehensive income		-	-	58,508	-	(4,146)	318	54,680	54,680
of which: Net profit / (loss) for the year				58,508				58,508	58,508
of which: Other comprehensive income						(4,146)	318	(3,828)	(3,828)
Total equity at 31 December 2018	39)	146,000	117,492	92,395	-	2,170	(193)	357,864	357,864

1) Details see in Note 39) Total equity, section Subscribed capital and additional paid-in capital, page 71.

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

Statement of changes in total equity for the year ended 31 December 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'	Attributable to owners of the parent	Total equity
Total equity at 01 January 2017		146,000	117,492	15,156	2,844	(221)	(256)	281,015	281,015
Total comprehensive income		-	-	54,754	3,586	221	(299)	58,262	58,262
of which: Net profit / (loss) for the year		-	-	54,754	-	-		54,754	54,754
of which: Other comprehensive income		-	-	-	3,586	221	(299)	3,509	3,509
Total equity at 31 December 2017		146,000	117,492	69,910	6,430	-	(555)	339,278	339,278

V. Consolidated Statement of Cash Flows

in HUF million	2017	2018
Net result for the period	54,754	58,508
Income tax adjustment	5,280	2,806
Income tax adjusted result for the period	60,034	61,314
Non-cash adjustments for items in net profit/loss for the year		
Depreciation, amortisation and net impairment of non-financial assets	10,317	12,174
Net allocation of credit loss allowances and other provisions	(36,820)	(19,059)
Gains/losses from measurement and derecognition of financial assets and financial liabilities	(4,284)	(572)
Revaluation of subordinated liabilities	(144)	(1,950)
Revaluation of derivatives	(1,939)	(1,247)
Other adjustments	260	3,968
from which changes of initial application of IFRS 9	-	3,878
Changes in assets and liabilities from operating activities after adjustment for non-cash components		
Financial assets - held for trading	(4,875)	27,006
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	2,964	x
Financial assets at fair value through other comprehensive income		
Equity instruments	x	239
Debt securities	x	(3,982)
Financial assets - held to maturity	(2,923)	x
Loans and receivables to credit institutions	76,828	x
Loans and receivables to customers	(86,188)	x
Financial assets at amortised costs		
Debt securities	x	21,521
Loans and advances to banks	x	(29,105)
Loans and advances to customers	x	(55,310)
Finance lease receivables	x	(37,903)
Other assets from operating activities	7,480	(17,888)
Financial liabilities - held for trading	(1,072)	1,501
Financial liabilities at fair value through profit or loss	13,103	(639)
Financial liabilities measured at amortised cost	116,531	320,120
Deposits from banks	(10,951)	68,267
Deposits from customers	121,802	189,570
Debt securities issued	5,680	59,461
Other financial liabilities	-	2,823
Other liabilities from operating activities	(2,220)	5,890
Payments for taxes on income	(5,226)	(7,066)
Cash flow from operating activities	141,826	205,441

Proceeds of disposal		
Financial assets - held to maturity	47,313	x
Financial assets - available for sale	65,987	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	43,392
Financial assets at amortised costs - Debt securities	x	105,236
Property and equipment, intangible assets and investment properties	426	243
Acquisition of		
Financial assets - held to maturity	(259,622)	x
Financial assets - available for sale	(58,926)	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	(56,865)
Financial assets at amortised costs - Debt securities	x	(211,307)
Property and equipment, intangible assets and investment properties	(21,731)	(11,493)
Cash flow from investing activities	(226,553)	(130,945)
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	106,050	21,324
Cash flow from operating activities	141,826	205,441
Cash flow from investing activities	(226,553)	(130,945)
Cash flow from financing activities	(0)	(40,000)
Cash and cash equivalents at end of period	21,324	55,819

Cash flows related to interest and dividends (included in cash flow from operating activities)	2017	2018
Interest received	81,372	78,321
Dividends received	81	37
Interest paid	(8,487)	(10,805)

VI. Notes to the Consolidated Financial Statements

A. GENERAL INFORMATION

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

The annual financial statements are published and available on the following website:

<https://www.erstebank.hu/hu>

The consolidated 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 Consolidated Financial Statements of Erste Group are prepared by the ultimate parent of Erste Group 'Erste Group Bank AG', and are available after their completion at the Court of Registry of Vienna, Marxergasse 1a, 1030 Vienna, Austria.

As of 31 December 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.

(Having no transactions with ERSTE Foundation the indirect significant influence has no impact on Erste Hungary's consolidated data.)

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.

Subsidiaries

The subsidiaries of the Bank, all registered in Hungary, as of 31 December 2018 are as follows:

Interest of Erste Bank Hungary in % - directly or indirectly			
Company name	2017	2018	Core activity
Erste Befektetési Zrt.	100%	100%	brokerage services
Erste Lakáslízing Zrt.	100%	100%	financial leasing of properties
Erste Ingatlan Kft.	100%	100%	property management
Sió Ingatlan Invest Kft.	100%	100%	property development
Erste Lakástakarék Zrt.	100%	100%	building society
Collat-Reál Kft.	100%	100%	property management
Erste Jelzálogbank Zrt.	100%	100%	refinancing activity

Erste Hungary's activity

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

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

B. 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 1.405 million forint as of 31 December 2018, representing assets decreased by liabilities after intercompany elimination. The sale is expected to be realised in the first half year of 2019.

C. 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, maximized in 72 thousand forint per year, per contract and contracts signed before 17 October 2018 stayed under the subsidized scheme.

D. ACCOUNTING POLICIES

a) BASIS OF PREPARATION

The consolidated financial statements of Erste Hungary 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).

In accordance with the applicable measurement models prescribed or permitted under IFRS, the consolidated 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.

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

The consolidated 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 consolidated 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.

Basis of consolidation

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

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

b) ACCOUNTING AND MEASUREMENT METHODS

Foreign currency translation

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

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

IFRS 9 Financial Instruments

As of 1 January 2018, Erste Hungary 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 Hungary 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	Com- ments	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 bal- ances		Loans and re- ceivables	AC	Amortised cost	21,324	21,323
Derivatives		Held-for-trading	FVPL	Held-for-trading (FVPL)	21,083	21,083
Other trading assets		Held-for-trading	FVPL	Held-for-trading (FVPL)	122,622	122,622
Loans and receiva- bles to credit institu- tions	a	Loans and re- ceivables	AC	Amortised cost	68,674	68,659
				Designated at FVPL	-	-
Loans and receiva- bles to customers	b	Loans and re- ceivables	AC	Amortised cost	1,031,091	1,032,836
				Mandatorily at FVPL	47,454	48,674
		Loans and re- ceivables	Finance Lease and trade receivables	Finance Lease and trade re- ceivables	45,152	44,936
Financial assets - available for sale (Debt securities)	AFS	FVOCI	Amortised cost	-	-	
			Mandatorily at FVPL	-	-	
			FVOCI	134,606	134,606	
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	640,992	640,886
				Mandatorily at FVPL	-	-
				Designated at FVPL	-	-
				FVOCI	10,908	11,274
Total financial as- sets					2,146,064	2,149,058
Financial liabilities						
Derivatives		Held-for-trading	FVPL	Held-for-trading (FVPL)	(15,092)	(15,092)
Other trading liabil- ities		Held-for-trading	FVPL	Held-for-trading (FVPL)	(70)	(70)
Financial liabilities measured at amor- tised cost	Amortised cost	AC	Amortised cost	(1,787,542)	(1,787,542)	
			Designated at FVPL	-	-	
Financial liabilities - at fair value through profit or loss (Debt securities issued)	FV option	FVPL	Designated at FVPL	(37,584)	(37,584)	
Total financial liabil- ities					(1,840,288)	(1,840,288)

(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 additional impairment as the effect of transition.

(b) A part of 'Loans and receivables to customers' were classified into 'Mandatorily at FVPL' valuation category and remeasured to fair value, as their contractual cash flow characteristics contain a leverage, IFRS9 column value representing their fair value. See in 'SPPI assessment' chapter, page 39.

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 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	1,831,583	-	-	1,831,583	-
Additions:		-	-	-	-	-
from IAS 39 AC (L&R, HTM) (impairment premeasurement)	b	-	-	1,571	1,571	(1,571)
Subtractions:						
to IFRS 9 FVOCI (IAS 39: HTM) – debt securities		-	-	-	-	-
to IFRS 9 FVTOCI (IAS 39: HTM)	c	-	(10,908)	-	(10,908)	-
to IFRS 9 Designated at FVPL (IAS 39: HTM) – debt securities		-	-	-	-	-
to IFRS 9 Mandatorily at FVPL (IAS 39: L&R) – loans and advances to customers	d	-	(47,454)	-	(47,454)	-
to IFRS 9 Mandatorily at FVPL (IAS 39: HTM) – debt securities		-	-	-	-	-
Total change		-	(58,362)	1,571	(56,790)	(1,571)
Total - amortised cost	e	1,831,583	(58,362)	1,571	1,774,793	(1,571)
Fair value through other comprehensive income		136,765	-	-	136,765	-
Fair value through other comprehensive income – debt securities	f	134,606	-	-	134,606	-
Additions:						
from IAS 39 AC (HTM)	c	-	10,908	367	11,274	(367)
from IAS 39 AFS (impairment remeasurement)		-	-	-	-	-
Subtractions:						
to IFRS 9 AC (IAS 39: AFS)						
to IFRS 9 Mandatorily at FVPL (IAS 39: AFS)						
Subtotal change – debt securities at FVOCI	c f	-	10,908	367	11,274	(367)
Subtotal – debt securities at FVOCI		134,606	10,908	367	145,881	(367)
Fair value through other comprehensive income – equity instruments		2,159	-	-	2,159	-
Subtractions:						
to IFRS 9 FVPL (IAS 39: AFS)	g	-	(970)	-	(970)	-
Subtotal change – equity instruments at FVOCI		-	(970)	-	(970)	-
Subtotal – equity instruments at FVOCI		2,159	(970)	-	1,189	-
Total change		-	9,938	367	10,305	(367)
Total – fair value through other comprehensive income		136,765	9,938	367	147,069	(367)

Fair value through profit or loss	h	143,705	-	-	143,705	-
<u>Additions:</u>						
from IAS 39 AC (L&R) (IFRS 9: Mandatorily at FVPL) – loans and advances to customers	c d	-	47,454	1,220	48,674	(1,220)
from IAS 39 FVOCI (AFS) – equity instruments	g	-	970	-	970	-
from hedge accounting derivatives						
<u>Subtractions:</u>						
to IFRS 9 AC (IAS 39: FVO) – debt securities		-	-	-	-	-
to IFRS 9 FVOCI (IAS 39: FVO) – debt securities		-	-	-	-	-
Total change		-	48,424	1,220	49,644	(1,220)
Total – fair value through profit or loss	h	143,705	48,424	1,220	193,349	(1,220)
Total – financial assets		2,112,053	-	3,158	2,115,211	(3,158)

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: 21,324;
- loans and receivables to credit institutions: 68,672;
- loans and receivables to customers: 1,089,606 (excluding finance lease receivables); and
- financial assets – held to maturity: 651,900.

(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 held to maturity securities (under IAS 39).

(d) 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.

(e) 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 644,094;
 - loans and advance to banks: 68,659;
 - loans and advances to customers: 1,029,628 and
 - other financial assets: 11,089.

(f) The carrying amount of debt securities at FVOCI (AFS) under IAS 39 compared to the amount presented in the 2017 financial statements, is not changed.

(g) 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.

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

- financial assets held for trading 143,705.

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: 21,083; and

- other financial assets held for trading: 122,622.

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

- derivatives: 21,083; and
- other financial assets held for trading: 122,622
- loans and advances to customers: 48,674
- equity instruments: 970.

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

in HUF million	Comments	IAS 39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS 9 carrying amount 1 January 2018	Retained earnings effects	OCI effects
Amortised cost	a	(1,787,542)	-	-	(1,787,542)	-	-
Subtractions:		-	-	-	-	-	-
Total change		-	-	-	-	-	-
Total – amortised cost	c	(1,787,542)	-	-	(1,787,542)	-	-
Fair value through profit or loss	d	(52,746)	-	-	(52,746)	-	-
Additions:		-	-	-	-	-	-
Total change		-	-	-	-	-	-
Total – fair value through profit or loss	e	(52,746)	-	-	(52,746)	-	-
Total – financial liabilities	f	(1,840,288)	-	-	(1,840,288)	-	-

(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: 202,560;
- deposits from customers: 1,540,898;
- debt securities issued: 44,084.

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

- derivatives – held for trading: 15,162.
- debt securities issued: 37,584.

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

- derivatives: 15,092;
- other financial liabilities held for trading: 70;
- debt securities issued: 37,584.

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	Reclassifications	Remeasurement	IFRS 9
	31 December 2017			01 January 2018
Debt instruments at AC	(57,544)	1,837	3,495	(52,211)
Debt instruments at FVOCI	-	(19)	-	(19)
Finance lease	(750)	-	(152)	(902)
Off balance-sheet exposures (loan commitments and guarantees given)	(3,560)	-	819	(2,741)
Trade receivable	(6)	-	(53)	(59)
Total	(61,861)	1,818	4,109	(55,934)

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 5,965 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	IFRS 9	Retained	OCI effects
	Closing balance 31 Dec 17	Opening balance 1 Jan 18	earnings effects	
Deferred tax liabilities	(584)	(558)	(17)	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.

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 under IFRS 9');

- 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 part "Fair value of financial instruments".

Initial recognition and measurement

i. Initial recognition

Financial instruments are initially recognised when Erste Hungary becomes a party to the contractual provisions of the instrument. Regular way (spot) purchases and sales of financial assets are recognised at 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 Hungary, 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 'Significant accounting judgements, assumptions and estimates' on page 39.

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 Hungary 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 Hungary 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 Hungary, this concerns certain loans to customers. 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 'Significant accounting judgements, assumptions and estimates' on page 39).

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 Hungary, 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 Hungary 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 17).

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 presented. 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 consolidated by Erste Hungary, 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 statement 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 Hungary 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 Hungary 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 Hungary 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.

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 Hungary 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 Hungary 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 18) 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 Hungary 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 Hungary 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	Fair value	Measurement principle		Financial instru- ment category
		Amortised cost	Other	
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 re- ceivables
thereof Finance lease			IAS 17	n/a
Loans and receivables to customers		x		Loans and re- ceivables
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 Hungary 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 Hungary 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 Hungary 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 Hungary 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 47) 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 Hungary 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 Hungary 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 Hungary 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 Hungary'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 Hungary 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 Hungary 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 Hungary 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 Hungary has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement;

and either:

- 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 Hungary 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 Hungary 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 unamortized 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 Hungary to manage exposures to interest rates, foreign currencies and other market price risks. Derivatives used by Erste Hungary 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.

Changes in the fair value (clean price) of derivatives designated as hedging instruments in fair value hedges are recognised in the statement of income in the line item ‘Net trading result’.

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

(i) Fair value hedge

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

(ii) Cash flow hedge

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

In the books of Erste Hungary, no 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 Hungary 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 Hungary 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 Hungary 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 Hungary 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 Hungary 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 Hungary is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. All other lease agreements at Erste Hungary are classified as operating leases. This mainly includes the leasing of commercial real estate, automobiles and small trucks.

i. Erste Hungary 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 Hungary operates as a lessor are finance leases.

ii. Erste Hungary as a lessee

As a lessee, Erste Hungary 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'.

Reposessed assets

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

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

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

Intangible assets

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

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

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

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

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

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

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

Trade and other receivables

Under this line item receivables from factoring transactions 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% (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 Hungary 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 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 Hungary provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its clients. Assets held in a fiduciary capacity are not reported in the financial statements, as they are not the assets of the Bank.

Dividends on 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 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 Hungary 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 Hungary 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. Erste Hungary has no insurance product in its own product portfolio, but offers it for client as an agent of insurance companies.

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 Hungary 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. They also include service costs for severance payments. Furthermore, restructuring provisions expenses may be part of personnel expenses.

viii. 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 Hungary'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 consolidated financial statements contain amounts that have been determined on the basis of judgements and by the use of estimates and assumptions. The estimates and assumptions used are based on historical experience and other factors, such as planning as well as expectations and forecasts of future events that are currently deemed to be reasonable. As a consequence of the uncertainty associated with these assumptions and estimates, actual results could in future periods lead to adjustments in the carrying amounts of the related assets or liabilities. The most significant 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 Hungary, 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 Hungary 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 Hungary comprises retail loans with a government subsidy element granted to the customer priced in a way that contractual cash flow 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 Hungary 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 Hungary, sales due to increases in credit risk, sales close to assets' maturity, infrequent sales triggered by a non-recurring event (such as changes in regulatory 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 Hungary 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

Hungary 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 Hungary 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 47) Risk management, part Credit risk. The development of loan loss provisions is described in Note 19) Financial assets at fair value through other comprehensive income, Note 24) Financial assets at amortised cost, and Note 27) Finance lease receivables. The development of loan loss provisions in the comparative period is included in Note 22) Loans and receivables to credit institutions and Note 23) 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 48) Fair value of financial and non-financial instruments.

Impairment of non-financial assets

Erste Hungary reviews its non-financial assets at each balance sheet date to assess whether there is an indication of impairment loss 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 31) Tax assets and liabilities.

Provisions

Recognition of provisions requires judgement with respect to whether Erste Hungary 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 37) Provisions, and further details on provisions for contingent credit liabilities in Note 47) Risk Management, part credit risk. Legal proceedings that do not meet the criteria for recognition of provisions are described in Note 50) 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 Hungary 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 Hungary 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 Hungary 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 Hungary 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 Hungary 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 Hungary will not apply IFRS 16 to any leases on intangible assets. Erste Hungary 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 Hungary 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 Hungary'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 Hungary'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 Hungary'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 Hungary'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 Hungary'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 Hungary'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 Hungary'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 Hungary's financial statements.

E. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1) Net interest income

in HUF million	2017	2018
Financial assets HTM	13,759	x
Loans and receivables	54,809	x
Financial assets at AC	x	66,743
Financial assets AFS	2,509	x
Financial assets at FVOCI	x	2,933
Finance lease receivables	-	776
Interest income	71,077	70,452
Non-trading financial assets at FVPL	x	4,219
Financial assets HFT	5,955	5,688
of which: Derivatives	3,027	3,954
Negative interest from financial liabilities	-	737
Other similar income	5,955	10,644
Interest and other similar income	77,032	81,096
Financial liabilities at AC	(8,423)	(7,513)
Interest expenses	(8,423)	(7,513)
Financial liabilities at FVPL	(917)	(810)
Financial liabilities HFT	(1,536)	(3,848)
of which: Derivatives	(1,536)	(3,848)
Other liabilities	-	(42)
Negative Interest from financial assets	-	(145)
Other similar expenses	(2,453)	(4,845)
Interest and other similar expenses	(10,876)	(12,358)
Net interest income	66,156	68,738

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 Hungary. 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	12,708	(2,343)	12,202	(2,110)
Issues	3,573	(243)	2,853	(154)
Transfer orders	7,582	(2,100)	7,763	(1,956)
Other	1,553	-	1,586	-
Asset management	8,109	(794)	9,601	(797)
Custody	35	(227)	29	(208)
Payment services	38,002	(8,195)	41,318	(7,824)
Card business	13,529	(5,608)	14,713	(4,873)
Other	24,473	(2,587)	26,605	(2,951)
Customer resources distributed but not managed	3,360	(19)	3,158	(19)
Insurance products	3,052	(18)	3,104	(19)
Building society brokerage	234	(1)	(6)	-
Other	74	-	60	-
Lending business	2,240	(2,267)	2,717	(2,458)
Guarantees given, guarantees received	223	(1)	262	(53)
Loan commitments given, loan commitments received	-	-	6	-
Other lending business	2,017	(2,266)	2,449	(2,405)
Other	730	(2,656)	720	(2,040)
Total fee and commission income and expenses	65,184	(16,501)	69,745	(15,456)
Net fee and commission income	48,683		54,289	

Net fee and commission income above include income of 2,312 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
Dividend income	81	37

4) Net trading result

in HUF million	2017	2018
Securities and derivatives trading	(681)	19,696
Foreign exchange transactions	11,655	(3,630)
Net trading result	10,974	16,066

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 realized 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 measurement/repurchase of financial liabilities designated at FVPL	(793)	640
Result from financial assets and liabilities designated at FVPL	(793)	(1,355)
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	(793)	(1,568)

6) Rental income from investment properties & other operating leases

in HUF million	2017	2018
Investment properties	1,180	1,220
Rental income from investment properties & other operating leases	1,180	1,220

Other operating expenses directly attributable to investment properties amounted to 614 million Forint in 2018 (584 million Forint in 2017). The relating depreciation was 331 million Forint in 2018 (298 million Forint in 2017).

7) General administrative expenses

in HUF million	2017	2018
Personnel expenses	(31,243)	(30,061)
Wages and salaries	(24,213)	(23,409)
Compulsory social security	(5,847)	(5,389)
Long-term employee provisions	(253)	(80)
Other personnel expenses	(930)	(1,183)
Other administrative expenses	(27,517)	(26,777)
Deposit insurance contribution	(2,682)	(2,380)
IT expenses	(8,895)	(9,673)
Expenses for office space ¹⁾	(6,603)	(6,226)
Office operating expenses	(2,385)	(2,245)
Advertising/marketing	(1,810)	(1,781)
Legal and consulting costs	(2,607)	(1,431)
Sundry administrative expenses	(2,535)	(3,041)
Depreciation and amortisation	(9,509)	(10,919)
Software and other intangible assets	(5,633)	(6,660)
Owner occupied real estate	(751)	(915)
Investment properties	(298)	(331)
Customer relationships	(1,368)	(1,482)
Office furniture and equipment and sundry property and equipment	(1,459)	(1,531)
General administrative expenses	(68,269)	(67,757)

- 1) 'Expenses for office space' includes rental expense related to headquarter office building and branches, presented in Note 42), page 76 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
Fully consolidated subsidiaries	220	229	220	223
Erste Befektetési Zrt.	139	147	143	144
Erste Ingatlan Kft.	26	27	22	25
Erste Lakástakarék Zrt.	40	42	37	38
Erste Jelzálogbank Zrt.	15	13	18	16
Total	3,047	3,097	3,123	3,081

8) 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

9) 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	343
Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss	x	343

10) Net impairment loss on financial assets

in HUF million	2017	2018
Financial assets AFS	448	x
Loans and receivables	(3,252)	x
Allocation to risk provisions	28,008	x
Release of risk provisions	(33,045)	x
Direct write-offs	5,436	x
Recoveries recorded directly to the income statement	(3,651)	x
Net impairment loss on financial assets	(2,804)	x

11) Impairment result from financial instruments

in HUF million	2017	2018
Financial assets at FVOCI	x	(8)
Financial assets at AC	x	6,424
Net allocation to credit loss allowances	x	6,084
Direct write-offs	x	(1,851)
Recoveries recorded directly to the income statement	x	2,572
Modification gains or losses	x	(381)
Finance lease	x	301
Net allocation of credit loss allowances for loan commitments and financial guarantees given	x	63
Impairment result from financial instruments	x	6,780

12) Other operating result

in HUF million	2017	2018
Other operating expenses	(45,058)	(25,293)
Allocation/(release) to other provisions ⁴⁾	(20,881)	-
Allocation/(release) to provisions for commitments and guarantees given	-	(458)
Levies on banking activities	(17,092)	(18,639)
Banking tax	(3,974)	(4,159)
Financial transaction tax	(13,118)	(14,480)
Other taxes	(307)	(493)
Recovery and resolution fund contributions ³⁾	(1,251)	(824)
Impairment on properties/movables/other intangible assets other than goodwill	(241)	(1,298)
Result from sales of other assets	(3,496)	-
Result from other operating expenses ⁵⁾	(1,790)	(3,581)
Other operating income	38,523	8,459
(Allocation)/release of other provisions	-	900
(Allocation)/release of provisions for commitments and guarantees given ⁴⁾	21,792	-
Government grant ¹⁾	1,814	1,750
Result from sales of properties/movables/other intangible assets other than goodwill	4,965	58
Result from sales of other assets	-	963
Income from upgrade on loans previously subject to FX settlement ²⁾	8,053	4,788
Negative goodwill recognised in profit or loss	374	-
Result from other operating income	1,525	-
Other operating result	(6,535)	(16,834)

1) Conforming to its accounting policies (see chapter D. Accounting policies, page 12) Erste Hungary recognises government grant in 'Deferred income' till the reasonable assurance on realisation. After reasonable assurance earned, realised government grant is presented within 'Other operating result'.

Details on balances regarding government grant see in Note 38), page 70-71 .

Erste Hungary recognises government grant related to the following:

- National Bank of Hungary (NBH) security program
NBH introduced a floating-rate-payer forint interest rate swap (IRS) facility with terms of three and five years starting from June 2014 and one with a term of ten years starting from July 2015. This facility applies some preferential elements to intensify usage of IRS

tenders and also additional purchase of government securities by Banks. Banks are entitled to the preferential element if the government security portfolio is kept at a given level. In 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 824 million (1,251 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 authorized 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 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').

5) Includes 614 million forint investment property expense (348 million forint in 2017)

13) 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	(5,226)	(6,215)
of which local business tax	(4,101)	(4,118)
of which local innovation tax	(592)	(606)
Prior period taxes	-	(17)
Deferred tax expense / income		
Current period deferred tax benefit / (expense)	(54)	3,426
Total	(5,280)	(2,806)

Deferred tax related to 'Fair Value reserve' has been recognized 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	60,034	61,314
At statutory income tax rate	(5,403)	(5,518)
Income not subject to tax	1,125	1,748
Non tax deductible expenses	(1,117)	(1,206)
Local business and innovation tax	(4,693)	(4,724)
Tax loss carry forward usage	3,716	2,109
Tax refund related to FX settlement	2,712	-
HAS to IFRS transition difference	-	656
Current period deferred tax benefit / (expense)	(54)	3,426
Other	(1,566)	703
Total tax expense	(5,280)	(2,806)

At 31 December 2018 the tax loss carried forward amounts to 143,121 million forint (2017: 168,195 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 (94,859 million forint);
- Tax loss carry forwards after 31 December 2014 is consumable for a limited period of 5 years, till 31 December 2020 (49,900 million forint).

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

Non tax deductible expenses are mainly arising from different accounting and tax depreciation schedule and provisioning. Income not subject to tax is also related to different accounting and tax depreciation schedule, provisioning (provision usage) and dividend received.

Deferred taxes are disclosed in detail in Note 31) page 64.

14) Cash and cash balances

in HUF million	2017	2018
Cash on hand	19,793	21,690
Cash balances at central banks	500	20,063
Other demand deposits at credit institutions	1,031	14,066
Cash and cash balances	21,324	55,819

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.

15) Derivatives – held for trading

in HUF million	2017			2018		
	Notional value	Positive fair value	Negative fair value	Notional value	Positive fair value	Negative fair value
Derivatives held in the trading book	6,006,468	17,913	14,867	5,936,812	21,074	18,262
Interest rate	1,196,809	11,763	4,941	1,015,767	7,973	5,536
Equity	7,271	47	169	6,358	53	45
Foreign exchange	4,802,193	6,103	9,757	4,914,687	13,048	12,681
Other	195	-	-	-	-	-
Derivatives held in the banking book	881,831	3,170	225	835,778	4,908	478
Interest rate	527,300	2,394	101	710,029	4,908	344
Foreign exchange	354,532	777	124	125,749	-	134
Total gross amounts	6,888,300	21,083	15,092	6,772,590	25,982	18,740
Total	6,888,300	21,083	15,092	6,772,590	25,982	18,740

16) Other financial assets held for trading

in HUF million	2017	2018
Equity instruments	1,778	3,563
Debt securities	120,844	91,099
General governments	89,744	62,105
Credit institutions	31,100	28,994
Other financial assets held for trading	122,622	94,663

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

in HUF million	2017		2018	
	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 on page 39. Debt securities contain government bonds.

18) Financial assets - available for sale

in HUF million	2017	2018
Equity instruments	2,159	
Debt securities	134,606	
General governments	114,898	
Other financial corporations	19,708	
Financial assets - available for sale	136,765	x

19) Financial assets at fair value through other comprehensive income**Equity instruments**

The carrying amount of Erste Hungary'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 Hungary recognized 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

in HUF million	Gross carrying amount				Credit loss allowances				Accumulated fair value changes	Fair value
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total		
2018										
Debt securities	146,617	-	-	146,617	(28)	-	-	(28)	1,548	148,165
General governments	136,547	-	-	136,547	(20)	-	-	(20)	1,496	138,043
Credit institutions	10,070	-	-	10,070	(8)	-	-	(8)	52	10,122
Total	146,617	-	-	146,617	(28)	-	-	(28)	1,548	148,165

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	01.01.2018	Additions	Derecognitions	Transfers between stages	Other changes in credit risk (net)	Other	31.12.2018
Stage 1	(19)	(19)	5	-	5	-	(28)
Total	(19)	(19)	5	-	5	-	(28)

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 recognized 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)'.

20) Financial assets – held to maturity

in HUF million	Gross carrying amount		Collective allowances		Net carrying amount	
	2017	2018	2017	2018	2017	2018
General governments	583,356		-		583,356	
Credit institutions	68,544		-		68,544	
Total	651,900	x	-	x	651,900	x

21) Securities

in HUF mil- lion	2017				2018				
	Loans and receivables to custom- ers and credit insti- tutions*	Other trading assets	Financial assets		At AC	Trading as- sets	Financial assets		
			Available for sale	Held to maturity			Mandatorily at FVPL	Designated at FVPL	At FVOCI
Bonds and other inter- est-bearing securities	3,288	120,844	134,606	651,900	736,784	91,099	0	30,702	148,165
Listed	-	48,614	114,899	600,159	703,876	64,438	0	30,702	148,165
Unlisted	3,288	72,230	19,708	51,741	32,909	26,661	0	0	0
Equity-re- lated securi- ties	-	1,778	1,331	-	x	3,563	1,138	x	1,483
Listed	-	1,775	-	-	x	3,560	0	x	0
Unlisted	-	3	1,331	-	x	3	1,138	x	1,483
Equity hold- ings	-	-	828	-	x	x	x	x	x
Total	3,288	122,622	136,765	651,900	736,784	94,663	1,138	30,702	149,648

22) Loans and receivables to credit institutions

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

Allowances for loans and receivables to credit institutions

in HUF million	01.01.2017	Allocations	Interest income from impaired loans	31.12.2017
Specific allowances	-	(3)	3	-
Loans and receivables	-	(3)	3	-
Credit institutions	-	(3)	3	-
Total	-	(3)	3	-

23) Loans and receivables to customers

in HUF million	Gross carrying amount	Specific allowances	Collective allow- ances	Net carrying amount
As of 31 December 2017				
Debt securities with customers	3,505	-	(217)	3,288
General governments	2,336	-	(30)	2,306
Non-financial corporations	1,169	-	(187)	982
Loans and advances to customers	1,178,492	(38,857)	(19,226)	1,120,409
General governments	9,221	-	(9)	9,212
Other financial corporations	21,838	(16)	(180)	21,642
Non-financial corporations	466,952	(4,713)	(9,682)	452,557
Households	680,481	(34,128)	(9,355)	636,998
Total	1,181,997	(38,857)	(19,443)	1,123,697

Allowances for loans and receivables to customers

in HUF million	01.01.2017	Allocations	Use	Re- leases	Interest in- come from impaired loans	Ex- change- rate and other changes	31.12.2017	Amounts written off	Recoveries of amounts previously written off
Specific allowances	(62,935)	(15,272)	13,960	23,568	1,680	142	(38,857)	(11,703)	5,436
Loans and advances to cus- tomers	(62,935)	(15,272)	13,960	23,568	1,680	142	(38,857)	(11,703)	5,436
Other financial corporations	(9)	(16)	-	8	-	-	(17)	(3)	4
Non-financial corporations	(21,443)	(2,599)	7,366	11,764	115	83	(4,714)	(11,684)	1,541
Households	(41,483)	(12,657)	6,594	11,796	1,565	59	(34,126)	(16)	3,891
Collective allowances	(16,269)	(12,731)	-	9,477	-	80	(19,443)	-	-
Debt securities with customers	(266)	(33)	-	61	-	21	(217)	-	-
General governments	(82)	-	-	46	-	6	(30)	-	-
Other financial corporations	-	-	-	0	-	0	0	-	-
Non-financial corporations	(184)	(33)	-	15	-	15	(187)	-	-
Loans and advances to cus- tomers	(16,003)	(12,698)	-	9,416	-	59	(19,226)	-	-
General governments	(4)	(5)	-	4	-	(4)	(9)	-	-
Other financial corporations	(126)	(115)	-	56	-	5	(180)	-	-
Non-financial corporations	(8,510)	(5,904)	-	4,675	-	57	(9,682)	-	-
Households	(7,363)	(6,674)	-	4,681	-	1	(9,355)	-	-
Total	(79,204)	(28,003)	13,960	33,045	1,680	222	(58,300)	(11,703)	5,436

24) Financial assets at amortised cost

Debt securities at amortised cost

Gross carrying amounts and credit loss allowances per impairment buckets

in HUF million	GCA				CLA				Carrying amount
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	
2018									
General governments	696,935	-	-	696,935	(101)	-	-	(101)	696,834
Credit institutions	39,486	-	-	39,486	(19)	-	-	(19)	39,467
Non-financial corporations	27	-	1,083	1,110	-	-	(627)	(627)	483
Total	736,448	-	1,083	737,531	(120)	-	(627)	(747)	736,784

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	Other changes in credit risk (net) and Transfer between stages	Other	As of
	01 January 2018					31 December 2018
Stage 1	(117)	(40)	29	8	-	(120)
Stage 2	(287)	-	112	175	-	-
Stage 3	-	-	-	(583)	(44)	(627)
Total	(404)	(40)	141	(400)	(44)	(747)

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 recognized 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 summarized 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 recognized (purchased) during the year 2018 and not sold by 31 December 2018 amounts to 249,363 million forint. The GCA of AC debt securities that were held at 1 January 2018 and de-recognized (matured or sold compliant to sale from HTC business model) during the year 2018 amounts to 183,716 million forint.

25) Loans and advances to banks at amortised cost

Loans and advances to banks at amortised cost

in HUF million	GCA				CLA				Carrying amount
	Stage 1	Stage 2	Stage 3	Total	Stage 1	Stage 2	Stage 3	Total	
2018									
Central banks	23,489	-	-	23,489	(2)	-	-	(2)	23,487
Credit institutions	74,327	-	-	74,327	(37)	-	-	(37)	74,290
Total	97,816	-	-	97,816	(39)	-	-	(39)	97,777

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	Transfers between stages	Other changes in credit risk (net)	Other	As of
	01 January 2018						31 December 2018
Stage 1	(15)	(39)	32	-	(19)	2	(39)
Stage 2	-	-	4	-	(4)	-	-
Stage 3	-	-	114	-	(239)	125	-

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 recognized 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 recognized during the year 2018 and not fully de-recognized by 31 December 2018 amounts to 80,686 million forint. The GCA of AC loans and advances to banks that were held as of 1 January 2018 and fully de-recognized during the year 2018 amounts to 54,009 million forint.

26) 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	To- tal	Carrying amount	
As of 31 December 2018												
General governments	14,597	-	-	-	14,597	(1)	(0)	-	-	(1)	14,596	
Other financial corporations	47,095	1	1	11	47,108	(112)	(0)	(1)	-	(113)	46,995	
Non-financial corporations	477,141	8,245	2,916	12,206	500,508	(1,396)	(485)	(2,262)	(544)	(4,687)	495,821	
Households	596,419	29,549	23,170	25,839	674,977	(3,023)	(4,667)	(17,680)	(10,509)	(35,879)	639,098	
Total	1,135,252	37,795	26,087	38,056	1,237,193	(4,532)	(5,152)	(19,943)	(11,053)	(40,680)	1,196,510	

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	(4,605)	(1,293)	809	679	(129)	(6)	37	(24)	(4,532)
General governments	(2)	(1)	2	-	-	-	-	-	(1)
Other financial corporations	(45)	(95)	158	9	(136)	-	-	(2)	(112)
Non-financial corporations	(1,347)	(359)	325	5	-	-	1	(22)	(1,396)
Households	(3,211)	(838)	324	665	7	(6)	36	-	(3,023)
Stage 2	(6,829)	(544)	1,099	(1,535)	795	(19)	1,895	(14)	(5,152)
Non-financial corporations	(2,162)	(54)	820	-	866	0	55	(9)	(485)
Households	(4,667)	(490)	279	(1,535)	(71)	(19)	1,840	(5)	(4,667)
Stage 3	(23,315)	(671)	4,112	(623)	(36)	(170)	786	(26)	(19,943)
Other financial corporations	(10)	-	-	-	9	-	-	-	(1)
Non-financial corporations	(2,760)	(157)	1,183	(533)	(11)	0	38	(21)	(2,262)
Households	(20,545)	(514)	2,929	(90)	(34)	(170)	748	(5)	(17,680)
POCI	(17,043)	-	2,127	-	3,575	(71)	371	(12)	(11,053)
Non-financial corporations	(2,676)	-	381	-	1,760	-	2	(11)	(544)
Households	(14,367)	-	1,746	-	1,815	(71)	369	(1)	(10,509)
Total	(51,792)	(2,508)	8,147	(1,479)	4,205	(266)	3,089	(76)	(40,680)

In category 'POCI' Erste Hungary doesn't recognize purchased credit impaired instruments, but presents instruments subject to derecognition and recognition as new instruments. These instruments are typically subject to contractual changes bearing characteristics with derecognition 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 recognized 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 unrecognized 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 summarized below:

in HUF million	Transfers between Stage 1 and Stage 2		Transfers between Stage 2 and Stage 3		Transfers between Stage 1 and Stage 3		POCI	
	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
General governments								
Other financial corporations	-	-	-	-	-	9	-	11
Non-financial corporations	4,099	2,637	483	1	1,218	3	72	1
Households	22,076	7,325	1,600	932	4,296	2,086	308	2,767
Total	26,175	9,962	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 recognized during the year 2018 and not fully de-recognized by 31 December 2018 amounts to 327,907 million forint. The GCA of the AC loans and advances to customers that were held at 1 January 2018 and fully de-recognized during the year 2018 amounts to 219,631 million.

The undiscounted amount of the lifetime expected credit losses considered in the initial measurement of the AC loans and advances to customers initially recognized and identified as POCI during the year 2018 amounted to 3,576 million forint.

27) Finance lease receivables

Gross carrying amounts and credit loss allowances per impairment buckets

in HUF million	GCA					CLA					Carrying amount
	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	
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	Charge-offs	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	(132)	(34)	-	-	27	-	-	9	(130)
Stage 2	(78)	(11)	-	-	26	-	-	6	(57)
Stage 3	(461)	-	-	-	112	-	9	26	(314)
POCI	(231)	-	-	-	184	-	-	-	(47)
Total	(902)	(45)	-	-	349	-	9	41	(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 recognized 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 summarized 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

28) Trade and other receivables

Gross carrying amounts and credit loss allowances per impairment buckets

in HUF million	Gross carrying amount					Credit loss allowances					Carrying amount
	Stage 1	Stage 2	Stage 3	POCI	Total	Stage 1	Stage 2	Stage 3	POCI	Total	
2018											
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)	11,286
Households	3	-	-	-	3	-	-	-	-	-	3
Total	14,124	46	-	-	14,170	(56)	(1)	-	-	(57)	14,113

Movement in credit loss allowances

in HUF million	01.01.2018	Additions	Derecognitions	Transfers between stages	Other changes in credit risk (net)	Other	31.12.2018
Stage 1	(59)	(65)	107	2	(41)	-	(56)
Stage 2	-	(1)	1	(1)	-	-	(1)
Total	(59)	(66)	108	1	(41)	-	(57)

29) Debt instrument subject to contractual modifications

As at 31 December 2018, the total GCA of Erste Bank Hungary'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

30) Fixed assets movement

Movements in fixed assets schedule

in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties
Value 01.01.2018	44,969	11,441	9,528	5,273	10,684	81,895	11,824
Additions	7,927	3	629	384	1,715	10,658	811
Disposals	(1,726)	(427)	(33)	(542)	(1,404)	(4,132)	-
Reclassification	(1)	298	(298)	-	1	-	-
Value 31.12.2018	51,169	11,315	9,826	5,115	10,996	88,421	12,635

DEPRECIATION AND IMPAIRMENT in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings ²⁾	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties ¹⁾
Value 01.01.2018	27,404	3,441	4,471	4,082	8,332	47,730	1,478
Additions	6,648	1,494	915	367	1,164	10,588	331
Disposals	(1,726)	(426)	(18)	(318)	(1,401)	(3,889)	-
Reclassification	(1)	294	(293)	11	1	12	(12)
Impairment	1,303	-	-	-	-	1,303	-
Value 31.12.2018	33,628	4,803	5,075	4,142	8,096	55,744	1,797

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

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

NET CARRYING AMOUNT in HUF million	Software acquired	Other intangible assets (licenses, patents, customer lists etc.)	Own land and buildings	Office and plant equipment/other fixed assets	IT-assets (hardware)	Subtotal	Investment properties
Value 01.01.2018	17,565	8,000	5,058	1,191	2,352	34,166	10,347
Value 31.12.2018	17,541	6,512	4,751	973	2,900	32,677	10,838

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

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

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

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

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

in HUF million	2017	2018
Intangible assets	25,565	24,053
Software acquired	17,565	17,541
Other intangible assets (licenses, patents, customer lists etc.)	8,000	6,512
Property and equipment	8,600	8,624
Own land and buildings	5,058	4,751
Office and plant equipment/other fixed assets	1,190	973
IT-assets (hardware)	2,352	2,900
Total intangible and tangible assets	34,165	32,677
Investment properties	10,347	10,838

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

31) Tax assets and liabilities

Major components of deferred tax assets and deferred tax liabilities

in HUF million	Tax assets		Tax liabilities		Net variance 2018		
	2017	2018	2017	2018	Total	through profit or loss	through other comprehensive income
Deferred taxes	-	3,362	585	167	3,780	3,476	305
Temporary differences related to the following items:			-	-	-		
Trading Assets / Liabilities and Designation at fair value through Profit or Loss	3,340	-	158	8	(3,190)	(3,189)	-
Financial assets at fair value through other comprehensive income	66	-	-	193	(259)	-	(259)
Financial assets at amortised cost & trade & other receivables	2,562	-	-	-	(2,562)	(2,562)	-
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)	-	-	421	-	421	421	-
Financial liabilities measured at amortized cost (deposits and debt securities issued)	-	-	3,723	-	3,723	3,723	-
Other provisions (tax valuation different)	375	2	1	-	(372)	(372)	-
Tax loss carry-forward	465	1,984	-	-	1,519	1,519	-
HAS - IFRS transition	-	1,536	-	-	1,536	1,536	-
Other	318	98	210	304	(313)	(313)	-
Impairment	(2,667)	(2)	-	-	2,665	2,665	-
Effect of netting gross deferred tax position	(4,493)	(338)	(4,493)	(338)	-	-	-
Current taxes	704	1,490	-	46	(6,233)	(6,233)	1,490
Total taxes	704	4,852	584	213	(2,453)	(2,757)	1,795

Erste Hungary allocated 3.4 billion forint deferred tax asset on consolidated level as of 31 December 2018, having the breakdown as follows:

- 1.55 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.
- 1.85 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 utilized. 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 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.

Erste Hungary recognized 0.2 billion forint deferred tax liability on consolidated level as of 31 December 2018 of which 0.14 billion forint comes from subsidiaries also subject to obligatory transition from local accounting standard to IFRS adopted by EU (see above) having a negative transitional difference.

32) Assets held for sale

in HUF million	2017	2018
Assets held for sale	1	1,405

‘Assets held for sale’ includes repossessed cars relating to the Erste Hungary’s leasing activity in 2017. In 2018 Erste Lakáslízing Zrt. has been classified as asset held for sale as described in section B. ACQUISITIONS, MERGERS AND DISPOSALS.

33) Other assets

in HUF million	2017	2018
Clearing accounts with tax authorities	640	805
Other clearing accounts	3,112	5,916
Other financial assets ²⁾	3,304	3,975
Other accrued income	3,096	3,344
Inventories	470	774
Repossessed assets ¹⁾	8,113	6,397
Prepaid expenses	1,831	2,011
Other	7,225	8,043
Total	27,791	31,265

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

The amount of the impairment of the repossessed assets is 0.3 million forint (in 2017: 862 million forint).

2) The balance of ‘Other financial assets’ contains performing, short-term customer receivables.

34) Other financial liabilities held for trading

in HUF million	2017	2018
Short positions	70	622
Equity instruments	70	622
Other financial liabilities held for trading	70	622

35) Financial liabilities at fair value through profit or loss

in HUF million	Carrying Amount		Amount repayable		Delta between carrying amount and amount repayable	
	2017	2018	2017	2018	2017	2018
Debt securities issued	37,584	36,945	35,982	35,982	1,602	963
Financial liabilities at FVPL	37,584	36,945	35,982	35,982	1,602	963

Fair value changes that are attributable to changes in own credit risk

in HUF million	For reporting period		Cumulative amount	
	2017	2018	2017	2018
Debt securities issued	-	(1)	-	(1)
Financial liabilities at FVPL	-	(1)	-	(1)

Debt securities issued

in HUF million	2017	2018
Other debt securities issued	37,584	36,945
Mortgage covered bonds	37,584	36,945
Debt securities issued	37,584	36,945

As it is described in the Accounting policy, the category 'at fair value through profit or loss' is used if such classification eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases. In case Erste Hungary opt for valuation at fair value, the carrying amount of mortgage bonds designated at fair value through profit or loss was 35,156 (in 2017: 36,339). By the legislation related to mortgage banks the interest rate risk is prescribed to be hedged. The risk is hedged by interest rate swaps (IRS). The original mismatch to eliminate through fair value option applied for mortgage bond issued is the different valuation base of IRS (at fair value) and mortgage bond issued (at amortised cost).

36) Financial liabilities at amortised costs**Deposits from banks**

in HUF million	2017	2018
Deposit from domestic banks	138,929	201,391
Deposit from foreign banks	63,632	67,486
of which by Austrian banks	62,350	64,209
of which subordinated liabilities	50,666	52,512
Total	202,560	268,877

Deposits from banks - subordinated liabilities

Maturity	Notional amount 2017		Notional amount 2018		Interest conditions
	in thousand EUR	in million HUF	in thousand EUR	in million HUF	
01 March 2024	100,000	31,014	100,000	32,151	3M EURIBOR + 3,92%, quarterly*
01 March 2024	28,312	8,781	28,312	11,253	3M EURIBOR+ 4,11%, quarterly*
01 March 2024	35,000	10,855	35,000	9,102	3M EURIBOR+ 3,83%, quarterly*
Total subordinated loans	163,312	50,650	163,312	52,506	

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

2) The Bank has not paid back material amount of subordinated deposits during 2017 and 2018.

Deposits from customers

in HUF million	2017	2018
Saving deposits	2,383	2,352
Other deposits	1,538,515	1,728,116
Public sector	52,479	35,074
Commercial customers	452,862	473,971
Private customers	828,479	990,867
Other financial institutions	204,695	228,204
Total	1,540,898	1,730,468

Debt securities issued

in HUF million	2017	Notional amount 2017	2018	Notional amount 2018
Bonds	6,036	6,248	7,647	4,227
of which subordinated liabilities	4,043	4,215	4,307	4,215
Mortgage bonds	37,263	37,296	95,073	105,736
Certificate of deposits	784	784	824	824
Total	44,083	44,328	103,544	110,787

Mortgage bonds increased by 68.440 HUF million in notional amount as a result of the two issues in the business year.

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		
Mortgage bonds						
EJBFN21B	HU0000653092	14 March 2018	21 April 2021	10,000	HUF	fixed 0,50% interest payments: yearly
EJBFN28A	HU0000653100	14 March 2018	22 October 2028	35,175	HUF	fixed 2,50% interest payments: yearly
EJBFN21A	HU0000652920	19 October 2016	27 October 2021	19,314	HUF	fixed 2,50% interest payments: yearly
EJBFN23A	HU0000653159	20 June 2018	24 November 2023	23,655	HUF	fixed 1,50% interest payments: yearly
EJBFN19A	HU0000652912	19 October 2016	30 October 2019	17,592	HUF	fixed 2,00% interest payments: yearly
Total				105,736		
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	648	HUF	zero coupon
ERSTE TARTÓS KÖTVÉNY 20180102	HU0000356423	24 June 2015	2 January 2018	625	HUF	zero coupon
Total				2,033		
Mortgage bonds						
EJBFN21A	HU0000652920	19 October 2016	27 October 2021	19,315	HUF	fixed 2,50% interest payments: yearly
EJBFN19A	HU0000652912	19 October 2016	30 October 2019	17,592	HUF	fixed 2,00% interest payments: yearly
Total				36,907		
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			

37) Provisions

in HUF million	2017	2018
Pending legal issues and tax litigation	2,422	1,616
Loan commitments and financial guarantees given	3,560	2,470
Provisions for guarantees - off balance sheet (defaulted customers)	569	x
Provisions for guarantees - off balance sheet (non-defaulted customers)	2,991	x
CLA for loan commitments and financial guarantees in Stage 1	x	917
CLA for loan commitments and financial guarantees in Stage 2	x	181
CLA for loan commitments and financial guarantees - Defaulted		1,372
Other provisions	2,709	3,207
Provisions for onerous contracts	-	-
Other	2,709	3,207
Provisions	8,691	7,293

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 Hungary 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 (826 million forint) 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 earlier 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.

Provision movement tables

Credit loss allowances for loan commitments and financial guarantees 2018

in HUF million	As of 01 January 2018	Additions	Derecogni- tions	Transfers between stages	Other changes in credit risk (net)	Other	As of 31 Decem- ber 2018
Stage 1	1,154	302	(74)	(465)	-	-	917
Stage 2	167	-	(46)	59	-	1	181
Defaulted	1,421	334	(1,323)	1,013	(73)	-	1,372
Total	2,742	636	(1,443)	607	(73)	1	2,470

Sundry provision 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 litiga- tion	2422	1113	(154)	(1765)	-	1616
Commitments and guarantees given out of scope of IFRS9	-	1162	0	(704)	200	658
Other provisions	2709	3204	(3270)	(248)	154	2549
Provisions for onerous contracts	-	-	-	-	-	-
Other	2709	3204	(3270)	(248)	154	2549
Provisions	5131	5479	(3424)	(2717)	354	4823

Provision movement 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	561	20,334	(15,196)	(5,016)	(332)	351
Other sundry provisions	2,931	9,287	(3,292)	(4,146)	-	4,780
Total	25,156	32,675	(18,488)	(30,252)	(399)	8,691

38) Other liabilities

in HUF million	2017	2018
Deferred income ¹⁾	2,414	545
Clearing accounts	9,774	16,236
Tax liabilities	1,575	1,050
Other financial liabilities ²⁾	1,869	1,458
Received payments on advance	5	1,518
Accruals of other expenses	12,239	12,330
Other liabilities	2,352	2,981
Total	30,228	36,118

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

- National Bank of Hungary (NBH) security program
NBH introduced a floating-rate-payer forint interest rate swap (IRS) facility with terms of three and five years starting from June 2014 and one with a term of ten years starting from July 2015. This facility applies some preferential elements to intensify usage of IRS tenders and also additional purchase of government securities by Banks. Banks are entitled to the preferential element if the government security portfolio is kept at a given level. In 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 (HRS) 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 HRS, 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
<u>At 31 December 2018</u>	<u>260 million forint</u>
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) The balance of 'Other financial liabilities' contains short-term supplier liabilities.

39) Total equity

in HUF million	2017	2018
Subscribed capital	146,000	146,000
Additional paid-in capital	117,492	117,492
Retained earnings and other reserves	75,786	94,372
Total	339,278	357,864
Attributable to owners of the parent	339,278	357,864

Subscribed capital and Additional paid-in capital

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

Additional paid-in capital relating to the issuance of the new shares amounted to 33,998,800,000 forints.

As 31 December 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 dematerialized 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 Consolidated Financial Statements of Erste Group are prepared by the ultimate parent of Erste Group 'Erste Group Bank AG', and are available after their completion at the Court of Registry of Vienna, Marxergasse 1a, 1030 Vienna, Austria.

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

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

Owner	31 December 2017		31 December 2018	
	Number of shares	Ownership share	Number of shares	Ownership share
Erste Group Bank AG	102,200,000,000	70%	102,200,000,000	70%
Corvinus Nemzetközi Befektetési Zrt.	21,900,000,000	15%	21,900,000,000	15%
European Bank for Reconstruction and Development	21,900,000,000	15%	21,900,000,000	15%
Total	146,000,000,000	100%	146,000,000,000	100%

Retained earnings and other reserves

Within 'Retained earnings and other reserves' the Bank records a 'General Reserve'. Section 83 of the Credit Institutions and Financial Enterprises Act obliges the Bank to allocate 'General Reserve' amounting to 10% of the actual year's profit after tax, as a non-distributable income. Any use of the reserve needs to be in connection to losses on the Bank's core activity. 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 75,022 million forint and 'Fair value reserve' of 2,170 million forint with related deferred tax of (193) million forint in 2018. In 2017 the amount of 'Retained earnings' was 58,288 million forint and the amount of 'Available for sale reserve' was 6,430 million forint with related deferred tax of (555) million forint.

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

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

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

Retail

The Retail segment is constituted by the branch network where Erste Hungary sells products mainly to private and micro customers (up to 1.0 million euro GDP weighted turnover). The Retail business line at Erste Hungary is divided into 5 regions.

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

Corporates

The Corporates segment comprises business done with corporate customers of different turnover size (small and medium-sized enterprises, Local Large Corporate and Group Large Corporate customers) as well as commercial real estate and public sector business. Small and medium-sized enterprises (SME) are clients which are under the responsibility of the local corporate commercial centre network, mainly consisting of companies with an annual turnover from EUR 1.0 million to EUR 50 million. The relevant results of workout / property management companies (Erste Ingatlan Kft. and Sió Ingatlan Invest Kft.) are also included into this segment.

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

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

Public Sector consists of three sets of customers: public sector, public corporations and non-profit sector. 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 Group, including the execution of trade, market making and short-term liquidity management. In addition, it comprises business connected with servicing financial institutions as clients including custody, depository services, commercial business (loans, cash management, trade & export finance). Besides the Bank's own activities, it also includes institutional clients (typically funds, and asset management companies) at the brokerage company (Erste Befektetési Zrt.)

Asset/Liability Management & Local Corporate 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.

On the other side it also includes the local corporate centre of EBH which comprises all non-core banking business activities such as non-profit servicing participations, intragroup eliminations within EBH partial group, dividends, refinancing costs of participations, all non-banking balance sheet positions (e.g. fixed assets, intangible assets) which cannot be allocated to other business segments as well as the profit and loss positions resulting from these balance sheet items. Apart from that the Corporate Centre includes the reconciliations to the accounting result. Besides that the Free Capital of EBH defined as a difference between the average IFRS capital and the sum of the average allocated equity to the operating segments is reported under ALM/Local Corporate Centre. The full results of mortgage/refinancing bank company (Erste Jelzálogbank Zrt.) is also included in this segment. The non-allocated subsidiaries like property management companies' Corporate Centre (Erste Ingatlan Kft., Sió Ingatlan Invest Kft., Collat-Real Kft.) are also recorded in this segment.

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

Business Segments

	Retail	Corporates	Group Mar- kets	ALM&LCC	TOTAL
in HUF million	2018	2018	2018	2018	2018
Net interest income	50,532	17,354	2,334	(1,482)	68,738
Net fee and commission income	41,325	8,216	5,679	(931)	54,289
Dividend income	0	0	0	37	37
Net trading result	5,040	2,831	5,223	2,972	16,066
Gains/losses from financial instruments at FVPL	(387)	5	0	(1,186)	(1,568)
Rental income from investment properties & other operating leases	0	1,220	0	0	1,220
General administrative expenses	(54,668)	(9,313)	(3,966)	190	(67,757)
thereof depreciation and amortization	(8,747)	(1,483)	(567)	(122)	(10,919)
Other gains/losses from derecognition of financial instruments not at FVPL	358	0	0	(15)	343
Impairment result from financial instruments	1,974	4,858	67	(119)	6,780
Other operating result	(7,639)	(4,343)	(736)	(4,116)	(16,834)
Levies on banking activities	(12,066)	(5,293)	(726)	(554)	(18,639)
Pre-tax result from continuing operations	36,535	20,828	8,601	(4,650)	61,314
Taxes on income	(3,515)	(858)	(642)	2,209	(2,806)
Post-tax result from continuing operations	33,020	19,969	7,960	(2,441)	58,508
Net result for the period	33,020	19,969	7,960	(2,441)	58,508
Net result attributable to owners of the parent	33,020	19,969	7,960	(2,441)	58,508
Operating income	96,510	29,626	13,236	(590)	138,782
Operating expenses	(54,668)	(9,313)	(3,966)	190	(67,757)
Operating result	41,842	20,313	9,270	(400)	71,025
Cost/income ratio	57%	31%	30%	32%	49%
Total assets (eop)	894,022	620,582	200,695	848,208	2,563,507
Total liabilities excluding equity (eop)	1,079,749	475,500	472,236	178,158	2,205,643
Impairments	1,975	4,857	67	(1,417)	5,482
Net impairment loss on financial assets AC	1,713	4,734	102	(125)	6,424
Net impairment loss on financial assets FVOCI	0	0	(6)	(2)	(8)
Net impairment loss on finance lease receivables	118	183	0	0	301
Net impairment loss on commitments and guarantees given	144	(60)	(29)	8	63
Net impairment on other non-financial assets	0	0	0	(1,298)	(1,298)

	Retail	Corporates	Group Mar- kets	ALM & LCC	Total group
in HUF million	2017	2017	2017	2017	2017
Net interest income	48,531	15,088	4,589	(2,052)	66,156
Net fee and commission income	37,621	7,587	4,907	(1,432)	48,683
Dividend income	0	0	0	81	81
Net trading result	3,143	3,043	3,829	959	10,974
Gains/losses from financial instruments at FVPL	0	0	0	(793)	(793)
Rental income from investment properties & other operating leases	0	1,180	0	0	1,180
General administrative expenses	(55,620)	(9,511)	(3,375)	237	(68,269)
thereof depreciation and amortization	(7,607)	(1,347)	(456)	(99)	(9,509)
Gains/losses from financial assets and liabilities not at FVPL, net	0	0	0	5,753	5,753
Net impairment loss on financial assets	7,634	3,793	(5)	(8,618)	2,804
Other operating result	(11,565)	1,831	(38)	3,237	(6,535)
Levies on banking activities	(9,541)	(3,692)	(179)	(3,680)	(17,092)
Pre-tax result from continuing operations	29,744	23,011	9,907	(2,628)	60,034
Taxes on income	(2,427)	(812)	(615)	(1,426)	(5,280)
Post-tax result from continuing operations	27,316	22,200	9,292	(4,054)	54,754
Net result for the period	27,316	22,200	9,292	(4,054)	54,754
Net result attributable to owners of the parent	27,316	22,200	9,292	(4,054)	54,754
Operating income	89,295	26,898	13,325	(3,237)	126,281
Operating expenses	(55,620)	(9,511)	(3,375)	237	(68,269)
Operating result	33,675	17,387	9,950	(3,000)	58,012
Cost/income ratio	62%	35%	25%	7%	54%
Total assets (eop)	831,915	504,473	210,453	672,228	2,219,069
Total liabilities excluding equity (eop)	961,049	473,537	327,721	117,484	1,879,791
Impairments	6,502	22,111	(17)	(8,865)	19,731
Net impairment loss on loans and receivables to credit institutions/customers	7,634	3,793	(5)	(8,170)	3,252
Net impairment loss on other financial assets	0	0	0	(448)	(448)
Net impairment loss on commitments and guarantees given	(1,067)	19,115	(12)	0	18,036
Net impairment on other non-financial assets	(65)	(797)	0	(247)	(1,109)

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

41) 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	409,782	473,872	23,900	32,994
EUR	329,188	406,252	15,695	8,984
CHF	15,986	11,511	175	154
USD	61,806	54,286	5,388	22,348
JPY	227	96	215	53
Other	2,575	1,727	2,427	1,455
Liabilities	532,342	520,557	72,584	76,084
EUR	391,634	421,118	64,925	67,595
CHF	6,323	6,441	1,041	1,078
USD	116,050	81,970	5,896	6,257
JPY	1,549	1,418	3	23
Other	16,786	9,610	719	1,131

Further details of the exchange rate open positions in Note 47), chapter 'Market risk'.

42) Leases

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

a) Finance leases

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

in HUF million	2017	2018
Outstanding minimum lease payments	37,678	40,573
Non-guaranteed residual values	6,901	8,936
Gross investment	44,579	49,509
Unrealised financial income	2,979	2,424
Net investment	41,600	47,085
Present value of non-guaranteed residual values	6,901	8,936
Present value of minimum lease payments	34,699	38,149
Risk provision related to outstanding minimum lease payments	(750)	(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	2017	2018	2017	2018
< 1 year	8,478	12,082	7,835	10,365
1-5 years	29,427	33,307	22,404	24,991
> 5 years	6,674	4,120	4,460	2,793
Total	44,579	49,509	34,699	38,149

b) Operating leases

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

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

Erste Hungary as lessee:

in HUF million	2017	2018
< 1 year	4,046	4,033
1-5 years	13,967	9,527
> 5 years	18,618	4,550
Total	36,631	18,110

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

43) Related party transactions

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

The following terms are used in the below table:

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

Loans and advances and amounts owed to related parties

in HUF million	2017	2018
Other demand deposits	1 031	11 814
Parent	1 031	11 814
Loans and advances to credit institutions¹⁾	7 684	28 652
Parent	7 676	28 428
Fellow subsidiaries	8	224
Loans and advances to customers	13 167	12 349
Fellow subsidiaries	13 167	12 349
Derivative financial instruments - asset	14 119	11 809
Parent	12 885	10 814
Fellow subsidiaries	1 234	995
Other assets	3 457	3 707
Parent	3 130	2 625
Fellow subsidiaries	327	1 082
Deposits by banks	12 832	14 805
Parent	11 549	11 682
Fellow subsidiaries	1 283	3 123
Customer deposits	2 855	2 444
Fellow subsidiaries	2 855	2 444
Derivative financial instruments - liabilities	8 335	11 405
Parent	8 335	11 405
Other liabilities	1 809	2 726
Parent	553	295
Fellow subsidiaries	1 256	2 431
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	929	3 378
Parent	769	2 938
Fellow subsidiaries	160	440
Interest Expense	(2 425)	(3 647)
Parent	(2 425)	(3 646)
Fellow subsidiaries	-	(1)
Fee and commission income	1 404	1 238
Parent	565	571
Fellow subsidiaries	839	667
Fee and commission expense	(222)	(211)
Parent	(74)	(96)
Fellow subsidiaries	(148)	(115)
Other Income/(Expense)	344	319
Parent	287	201
Fellow subsidiaries	57	118

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

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

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 be 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.

44) Collateral

The following assets were pledged as security for liabilities:

in HUF million	2017	2018
Financial assets at amortised cost	x	249,526
Loans and advances to customers	x	178,878
Debt securities at AC	x	70,648
Financial assets - at FVOCI	x	11,264
Loans and receivables to credit institutions and customers	278,653	x
Financial assets - held for trading	1,682	x
Financial assets - available for sale	15,094	x
Financial assets - held to maturity	51,949	x
Total	347,378	260,790

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). See the details of the program in Note 12), Other operating result table, comment 1), on page 48-49.

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

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

Securities lending and repurchase transactions

in HUF million	2017		2018	
	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	1,307	x	x
Financial assets - at AC	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.

in HUF million	2017			2018		
	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	1 288	1 307	(19)	x	x	x
Financial assets - at AC	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 Hungary under sale and repurchase agreements largely consist of securities.

46) 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 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	25 982	-	25 982	10 686	-	-	15 296
Total	25 982	-	25 982	10 686	-	-	15 296

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	18 740	-	18 740	10 686	-	-	8 054
Repurchase agreements	15 024	-	15 024	-	-	15 021	3
Total	33 764	-	33 764	10 686	-	15 021	8 057

Financial assets subject to offsetting and potential offsetting agreements in 2017

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

Liabilities subject to offsetting and potential offsetting agreements 2017

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

47) Risk management**47.1 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.

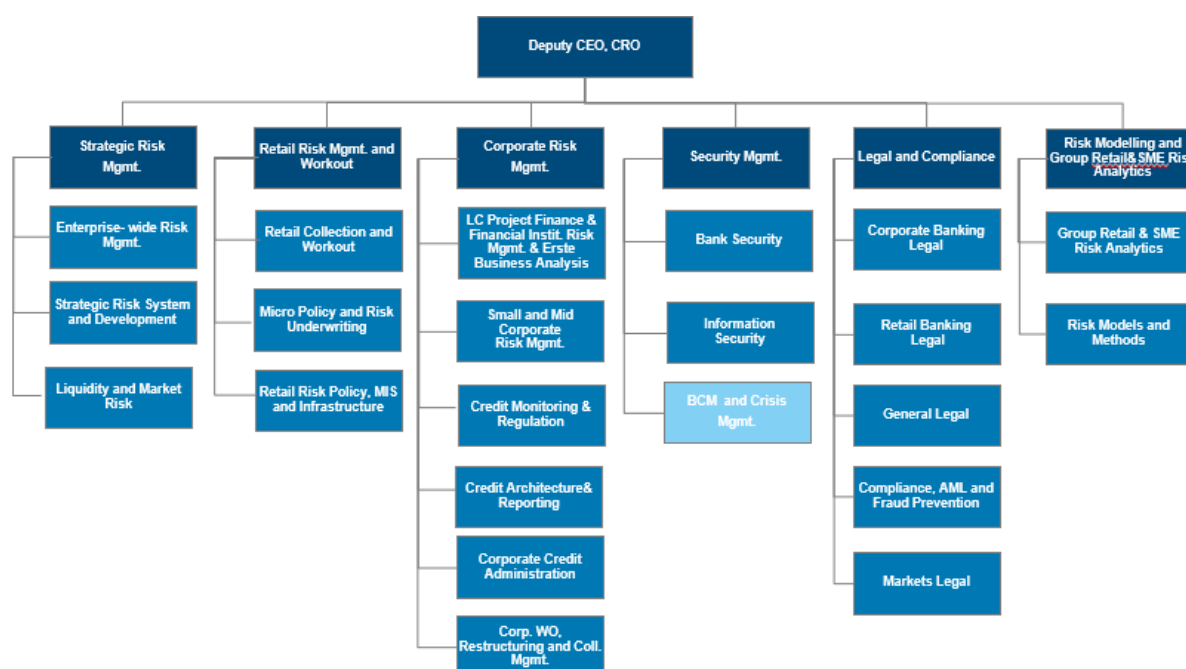
In 2018, management has continued to steer critical portfolios, including active management of non-performing exposures to further strengthen the risk profile. This has been particularly demonstrated by the continuous improvement of the credit quality and the ongoing decrease of non-performing loans 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 Hungary Zrt. 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 Hungary Zrt. has opted for the Internet as the medium of this publication.

47.2 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 Hungary Zrt. 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 Hungary Zrt. 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 Hungary'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 Hungary Zrt. 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 Hungary Zrt. 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.

47.3 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 Hungary Zrt.

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 Hungary Zrt. 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

Approved approaches and transitional rules by the regulator

Erste Bank Hungary Zrt. 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 ECAs

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 Hungary Zrt. 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 Hungary Zrt. 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 Hungary Zrt. 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 derived 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 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 unutilized 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 allow- ances	Adjustments	Net carrying amount
As of 31 December 2018				
Cash and cash balances - demand deposits to central banks and credit institutions	14,068	2	-	14,066
Derivatives and debt instruments held for trading	117,082	-	-	117,082
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	146,617	28	1,548	148,165
Debt securities	146,617	28	1,548	148,165
Debt instruments at AC	2,072,538	41,467	-	2,031,071
Debt securities	737,531	747	-	736,784
Loans and advances to banks	97,816	39	-	97,777
Loans and advances to customers	1,237,191	40,680	-	1,196,510
Trade and other receivables	14,171	58	-	14,113
Finance lease receivables	38,149	547	-	37,602
Off balance-sheet exposures	449,350	3,129	-	-
Total	2,924,408	45,230	1,548	2,434,533

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 categorized in the following way:

- Basel 3 exposure class and financial instrument;
- counterparty sector 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 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.

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	At amortised cost					Debt instruments held for sale in disposal groups	Positive fair value of hedge accounting derivatives	Off balance-sheet exposures	Total
					Debt securities	Loans and advances to banks	Loans and advances to customers	Trade and other receivables	Finance lease receivables				
As of 31 December 2018													
Sovereigns	-	68,509	30,702	136,547	696,935	23,489	-	719	-	-	-	-	956,902
Institutions	14,068	42,255	78	10,070	24,475	74,320	14,901	2,105	-	-	-	56,255	238,528
Corporates	-	6,317	604	-	16,121	7	540,233	11,345	35,398	-	-	262,063	872,087
Retail	-	1	41,050	-	-	-	682,056	1	2,751	-	-	131,032	856,891
Total	14,068	117,082	72,434	146,617	737,531	97,816	1,237,191	14,171	38,149	-	-	449,350	2,924,408

in HUF mil- lion	Cash and cash bal- ances – other demand de- posits	Loans and re- ceivables to credit institu- tions	Loans and re- ceivables to customers	Debt securities				Positive fair value of deriva- tives	Contin- gent li- abilities	Total credit risk exposure
				Financial assets - held to ma- turity	Financial assets - held for trading	Financial as- sets - at fair value through profit or loss	Financial as- sets - availa- ble for sale			
				At amortised cost		At fair value				
As of 31 De- cember 2017										
Sovereigns	-	28,985	3,643	583,356	91,522	-	117,057	1,602	30,000	856,165
Institutions	1,031	39,687	21,838	68,544	31,100	-	-	15,440	16,143	193,784
Corporates	-	-	475,952	-	-	-	19,708	4,041	149,077	648,778
Retail	-	-	680,564	-	-	-	-	-	104,713	785,276
Total	1,031	68,672	1,181,997	651,900	122,622	-	136,765	21,083	299,933	2,484,003

Credit risk exposure by counterparty sector and financial instrument

in HUF mil- lion	Cash and cash bal- ances - dem- and de- posits to central banks and credit insti- tutions	Derivatives and debt in- struments held for trading	Non-trading debt instru- ments at FVPL	Debt in- stru- ments at FVOCI	At amortised cost					Debt in- stru- ments held for sale in disposal groups	Posi- tive fair value of hedge ac- count- ing deriva- tives	Off bal- ance- sheet expo- sures	Total
					Debt secu- rities	Loans and advances to banks	Loans and ad- vances to custom- ers	Trade and other receiv- ables	Fi- nance lease receiv- ables				
As of 31 December 2018													
Central banks	-	6,404	-	-	-	23,489	-	-	-	-	-	-	29,893
General govern- ments	-	62,105	30,780	136,547	696,935	-	14,597	719	-	-	-	37,992	979,676
Credit insti- tutions	14,068	39,895	-	10,070	39,486	74,327	-	1	-	-	-	18,250	196,096
Other finan- cial corpo- rations	-	3,378	-	-	-	-	47,107	2,104	36	-	-	21,446	74,071
Non-finan- cial corpo- rations	-	5,300	668	-	1,110	-	500,507	11,343	34,284	-	-	245,731	798,943
Households	-	-	40,986	-	-	-	674,980	3	3,829	-	-	125,932	845,730
Total	14,068	117,082	72,434	146,617	737,531	97,816	1,237,191	14,171	38,149	-	-	449,350	2,924,408

in HUF million	Cash and cash balances – other demand deposits	Loans and receivables to credit institutions	Loans and receivables to customers	Debt securities				Positive fair value of derivatives	Contingent liabilities	Total credit risk exposure
				Financial assets - held to maturity	Financial assets - held for trading	Financial assets - at fair value through profit or loss	Financial assets - available for sale			
				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	-	-	124,782	-	-	-	-	235	81,029	206,046
Energy and water supply	-	-	13,707	-	-	-	-	21	6,480	20,208
Construction	-	-	6,389	-	-	-	-	1	9,153	15,544
Trade	-	-	56,938	-	-	-	-	98	9,963	66,999
Transport and communication	-	-	31,325	-	-	-	-	1,734	1,149	34,208
Hotels and restaurants	-	-	10,296	-	-	-	-	-	1,352	11,648
Financial and insurance services	1,031	68,672	19,279	68,544	31,100	-	-	15,568	16,143	220,338
Real estate and housing	-	-	150,204	-	-	-	-	2,022	36,509	188,734
Services	-	-	42,031	-	-	-	-	1,391	2,334	45,757
Public administration	-	-	3,824	583,356	91,522	-	136,765	-	30,000	845,467
Education, health and art	-	-	3,310	-	-	-	-	-	35	3,344
Private households	-	-	673,195	-	-	-	-	-	104,611	777,806
Other	-	-	-	-	-	-	-	12	-	12
Total	1,031	68,672	1,181,997	651,900	122,622	-	136,765	21,083	299,933	2,484,003

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
Loan commitments	347,252	402,747
Other commitments	2,538	46,295
Total	381,499	449,350

Credit risk exposure by industry and financial instrument

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	At amortised cost			Trade and other receivables	Finance lease receivables	Debt instruments held for sale in disposal groups	Positive fair value of hedge accounting derivatives	Off balance-sheet exposures	Total
					Debt securities	Loans and advances to banks	Loans and advances to customers						
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	-	41	-	-	-	-	19,733	56	534	-	-	16,970	37,333
Development of building projects	-	41	-	-	-	-	10,216	-	-	-	-	929	11,186
Trade	-	157	76	-	-	-	57,351	6,250	3,066	-	-	27,834	94,733
Transport and communication	-	1,250	222	-	-	-	18,206	46	19,960	-	-	10,687	50,372
Hotels and restaurants	-	167	166	-	-	-	8,969	13	325	-	-	2,169	11,808
Financial and insurance services	14,068	49,677	-	10,070	39,486	97,816	84,572	2,106	53	-	-	78,694	376,542
Holding companies	-	1	-	-	-	-	36,963	-	8	-	-	38,983	75,955
Real estate and housing	-	2,613	-	-	27	-	163,157	-	227	-	-	20,224	186,248
Services	-	4	27	-	13,127	-	39,156	588	3,622	-	-	8,762	65,287
Public administration	-	62,105	30,780	136,547	683,808	-	14,597	719	-	-	-	37,992	966,548
Education, health and art	-	-	38	-	-	-	1,943	-	501	-	-	865	3,347
Households	-	-	40,966	-	-	-	665,853	3	2,639	-	-	123,333	832,794
Other	-	-	-	-	-	-	93	-	-	-	-	2	95
Total	14,068	117,082	72,434	146,617	737,531	97,816	1,237,191	14,171	38,149	-	-	449,350	2,924,408

in HUF million	Cash and cash balances – other demand deposits	Loans and receiv- ables to credit in- stitutions	Loans and receivables to customers	Debt securities				Positive fair value of deriva- tives	Contingent liabilities	Total credit risk expo- sure
				Financial as- sets - held to maturity	Financial as- sets - held for trading	Financial assets - at fair value through profit or loss	Financial as- sets - available for sale			
			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	-	-	124,782	-	-	-	-	235	81,029	206,046
Energy and water supply	-	-	13,707	-	-	-	-	21	6,480	20,208
Construction	-	-	6,389	-	-	-	-	1	9,153	15,544
Trade	-	-	56,938	-	-	-	-	98	9,963	66,999
Transport and communication	-	-	31,325	-	-	-	-	1,734	1,149	34,208
Hotels and restaurants	-	-	10,296	-	-	-	-	-	1,352	11,648
Financial and insurance services	1,031	68,672	19,279	68,544	31,100	-	-	15,568	16,143	220,338
Real estate and housing	-	-	150,204	-	-	-	-	2,022	36,509	188,734
Services	-	-	42,031	-	-	-	-	1,391	2,334	45,757
Public administration	-	-	3,824	583,356	91,522	-	136,765	-	30,000	845,467
Education, health and art	-	-	3,310	-	-	-	-	-	35	3,344
Private households	-	-	673,195	-	-	-	-	-	104,611	777,806
Other	-	-	-	-	-	-	-	12	-	12
Total	1,031	68,672	1,181,997	651,900	122,622	-	136,765	21,083	299,933	2,484,003

Credit risk exposure by 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	2,571,113	41,081	29,864	38,626	2,680,684	233,884	2,914,568
Austria	40,969	9	5	1	40,984	10,859	51,842
Croatia	28	-	1	9	39	-	39
Romania	896	21	10	53	980	41	1,020
Serbia	41	4	1	-	46	-	46
Slovakia	658	9	22	3	693	21	714
Czech Republic	16	2	-	-	18	1,742	1,760
Hungary	2,528,505	41,036	29,825	38,559	2,637,924	221,222	2,859,147
Other EU	4,368	104	94	70	4,637	1,879	6,515
Other industrialised countries	2,629	27	5	-	2,662	-	2,662
Emerging markets	444	33	49	90	616	47	663
Southeastern Europe/CIS	148	13	14	68	243	11	254
Asia	124	12	22	17	175	-	175
Latin America	56	1	1	-	58	3	61
Middle East/Africa	115	7	13	5	140	34	174
Total	2,578,553	41,246	30,013	38,786	2,688,598	235,810	2,924,408

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

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	52,277	417	52,694
Mining	346	1	-	-	347	894	1,241
Manufacturing	201,184	748	63	363	202,358	7,464	209,822
Energy and water supply	31,324	267	1,089	248	32,929	2,615	35,544
Construction	25,224	322	1,470	618	27,633	9,701	37,333
Development of building projects	10,689	30	5	332	11,056	130	11,186
Trade	85,100	1,680	1,423	198	88,402	6,332	94,733
Transport and communication	42,639	834	18	403	43,894	6,477	50,372
Hotels and restaurants	11,188	235	25	17	11,465	343	11,808
Financial and insurance services	314,896	934	1	11	315,843	60,699	376,542
Holding companies	66,552	554	-	-	67,106	8,849	75,955
Real estate and housing	166,524	2,992	974	10,549	181,039	5,209	186,248
Services	62,088	1,068	173	186	63,514	1,740	65,254
Public administration	873,663	-	-	-	873,663	92,885	966,548
Education, health and art	3,201	69	4	5	3,279	68	3,347
Households	710,362	30,588	24,733	26,177	791,860	40,966	832,826
Other	88	2	3	3	95	-	95
Total	2,578,553	41,246	30,013	38,786	2,688,598	235,810	2,924,408

Credit risk exposure by risk category

in HUF million	Low risk	Management attention	Substandard	Non-performing*	Total
As of 31 December 2018	2,515,934	255,774	99,498	53,202	2,924,408
Share of credit risk exposure	86.0%	8.7%	3.4%	1.8%	100.0%
As of 31 December 2017	2,240,682	144,139	32,480	66,704	2,484,005
Share of credit risk exposure	90.20%	5.80%	1.31%	2.69%	100.00%

*Non-performing exposures:

The EBA Guideline for non-performing exposures comprises all defaulted exposures and all forbore 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 forbore 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 forbore exposure “under probation” (PFUP) which becomes 30 days past due on the forbore 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	355,145	7,929	13,095	373	376,542
Holding companies	73,771	1,116	1,067	-	75,955
Real estate and housing	161,746	9,305	14,216	980	186,248
Services	50,190	11,949	2,816	331	65,287
Public administration	966,548	-	-	-	966,548
Education, health and art	1,720	919	703	4	3,347
Households	561,007	170,517	55,679	45,591	832,794
Other	65	13	15	3	95
Total	2,515,934	255,774	99,498	53,202	2,924,408

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	751	206,046
Energy and water supply	15,050	2,159	1,116	1,884	20,208
Construction	12,316	3,069	9	150	15,544
Trade	58,366	7,218	157	1,258	66,999
Transport and communication	31,348	2,633	40	187	34,208
Hotels and restaurants	10,480	668	450	50	11,648
Financial and insurance services	220,333	4	-	1	220,338
Real estate and housing	161,109	9,431	14,732	3,463	188,734
Services	42,405	2,859	117	375	45,757
Public administration	845,275	11	-	181	845,467
Education, health and art	908	1,024	1,411	1	3,344
Private households	613,834	91,830	14,161	57,982	777,806
Other	-	12	-	-	12
Total	2,240,680	144,139	32,480	66,704	2,484,003

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	2,571,113	41,081	29,864	38,626	2,680,684	233,884	2,914,568
Austria	40,969	9	5	1	40,984	10,859	51,842
Croatia	28	-	1	9	39	-	39
Romania	896	21	10	53	980	41	1,020
Serbia	41	4	1	-	46	-	46
Slovakia	658	9	22	3	693	21	714
Czech Republic	16	2	0	-	18	1,742	1,760
Hungary	2,528,505	41,036	29,825	38,559	2,637,924	221,222	2,859,147
Other EU	4,368	104	94	70	4,637	1,879	6,515
Other industrialised countries	2,629	27	5	-	2,662	-	2,662
Emerging markets	444	33	49	90	616	47	663
Southeastern Europe/CIS	148	13	14	68	243	11	254
Asia	124	12	22	17	175	-	175
Latin America	56	1	1	-	58	3	61
Middle East/Africa	115	7	13	5	140	34	174
Total	2,578,553	41,246	30,013	38,786	2,688,598	235,810	2,924,408

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	669,316	188,425	70,148	46,361	974,249
Corporates	798,036	65,223	27,111	6,842	897,211
Group Markets	1,021,962	2,125	2,192	-	1,026,279
Asset/Liability Management and Local Corporate Centre	26,621	-	47	-	26,668
Total	2,515,934	255,774	99,498	53,202	2,924,408

in HUF million	Low risk	Management attention	Substandard	Non-performing	Total
As of 31 December 2017					
Retail	758,022	92,558	14,459	58,614	923,652
Corporates	604,274	48,734	18,021	8,090	679,119
Group Markets	865,385	22	-	-	865,408
Asset/Liability Management and Local Corporate Centre	13,001	2,825	-	-	15,826
Total	2,240,682	144,139	32,480	66,704	2,484,005

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	822,470	32,901	25,379	26,346	907,096	67,154	974,249
Corporates	821,607	8,345	4,634	12,439	847,025	50,186	897,211
Group Markets	907,809	-	-	-	907,809	118,470	1,026,279
Asset/Liability Management and Local Corporate Centre	26,668	-	-	-	26,668	-	26,668
Total	2,578,553	41,246	30,013	38,786	2,688,598	235,810	2,924,408

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 loss allow- ances	Collateral for NPE		NPE ratio		NPE coverage (excl. collateral)		NPE collateraliza- tion ratio	
in HUF million	Total	AC and FVOCI	Total	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	46,361	45,965	974,249	907,096	38,482	25,296	24,983	4.76%	5.07%	83.01%	83.72%	54.56%	54.35%
Corporates	6,842	6,366	897,211	847,025	5,887	2,770	2,765	0.76%	0.75%	85.05%	92.48%	40.49%	43.44%
Group Markets	-	-	1,026,279	907,809	200	-	-	0.00%	0.00%				
Asset/Liability Man- agement and Local Corporate Centre	-	-	26,668	26,668	2	-	-	0.00%	0.00%				
Total	53,202	52,330	2,924,408	2,688,598	44,571	28,066	27,748	1.82%	1.95%	85.02%	85.17%	52.75%	53.02%

		Total credit risk exposure						
in HUF million		Non-performing	Total credit risk exposure	Total credit risk provisions	Specific allow- ances & provi- sions	Collective al- lowances & provisions	NPE ratio	NPE cover- age ratio (excl. collat- eral)
As of 31 December 2017								
Retail		58,614	923,652	46,072	34,599	11,473	6.35%	78.60%
Corporates		8,090	679,119	15,661	4,449	11,212	1.20%	193.59%
Group Markets		-	865,408	11	-	11	0.00%	21204.02%
Asset/Liability Management and Local Corporate Centre		-	15,826	116	-	116	0.00%	
Total		66,704	2,484,005	61,861	39,048	22,813	2.69%	92.74%

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 annualized 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 annualized PD and annualized 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 consolidated 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 breached however overall PD is very low, therefore SICR is not positively concluded.

in HUF million Dec 18	Threshold intervals		Sensitivity analysis			
	Min	Max	Threshold change +/- 0.5		Threshold change +/- 1	
			ECL impact increase*	ECL impact decrease*	ECL impact increase	ECL impact decrease
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.

Baseline, upside and downside scenarios of GDP development by geographical segment:

	Scenario	Probability weight	2018	2019	2020	2021
Hungary	Upside	41%	4.7	4.6	3.8	3.8
	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 recognized 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	5,276	-
Collective allowances	33,826	-
Provisions for guarantees	22,964	-
Credit loss allowances		42,101
Loss allowances for loan commitments and financial guarantees		2,470
Total	62,066	44,571

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	1,429,070	914,850	177,752	402,747	2,924,408
thereof gross forborne exposure	14,248	1,083	-	42	15,373
Performing exposure	1,380,372	913,767	177,281	399,797	2,871,206
thereof performing forborne exposure	5,808	-	-	42	5,850
Credit loss allowances for performing exposure	9,834	148	317	1,100	11,400
thereof credit loss allowances for performing forborne exposure	170	-	-	-	171
Non-performing exposure	48,698	1,083	471	2,951	53,202
thereof non-performing forborne exposure	8,441	1,083	-	-	9,524
Credit loss allowances for non-performing exposure	31,492	627	592	1,120	33,831
thereof credit loss allowances for non-performing forborne exposure	4,323	627	-	-	4,949

in HUF million	Loans and re- ceivables	Financial assets	Other bal- ance-sheet positions	Contingent lia- bilities	Total
As of 31 December 2017					
Gross exposure	1,250,671	932,370	1,031	299,933	2,484,005
thereof gross forborne exposure	20,808	1,114	-	36	21,959
Performing exposure	1,185,812	932,370	1,031	297,760	2,417,301
thereof performing forborne exposure	8,705	1,114	-	36	9,856
Credit risk provisions for performing exposure	19,240	217	-	2,991	22,449
thereof credit risk provisions for performing forborne exposure	621	217	-	-	838
Non-performing exposure	64,859	-	-	2,172	66,704
thereof non-performing forborne exposure	12,103	-	-	-	12,103
Credit risk provisions for non-performing exposure	38,791	-	-	569	39,361
thereof credit risk provisions for non-performing forborne exposure	4,965	-	-	-	4,965

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

Loans and advances figures includes lease, trade and other receivables

Credit quality of forbearance exposure by geographical segment

in HUF million	Gross forborne ex- posure	Neither past due nor credit impaired	Past due but not credit im- paired	Credit impaired	Collateral	Credit loss allow- ances
As of 31 December 2018						
Austria	-	-	-	-	-	-
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
Other	-	-	-	-	-	-
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						
Austria	-	-	-	-	-	-
Central and Eastern Europe	21 865	11 348	2 370	8 147	13 383	-5 549
Hungary	21 830	11 332	2 370	8 127	13 365	-5 538
Other	94	65	-	28	52	-20
Total	21 959	11 413	2 370	8 175	13 435	-5 570

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 and companies. 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

		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						
Retail	974,249	430,341	15,627	390,756	23,957	543,909
Corporates	897,211	316,569	65,106	151,779	99,684	580,643
Group Markets	1,026,279	18,250	18,250	-	-	1,008,029
Asset/Liability Management and Local Corporate Centre	26,668	4,669	-	47	4,622	22,000
Total	2,924,408	769,828	98,983	542,582	128,263	2,154,580
As of 31 December 2017						
Retail	923,652	398,244	2,795	379,036	16,413	525,408
Corporates	679,119	236,820	43,782	118,668	74,371	442,298
Group Markets	865,408	9,959	6,185	37	3,737	855,448
Asset/Liability Management and Local Corporate Centre	15,826	-	-	-	-	15,826
Savings Banks	-	-	-	-	-	-
Group Corporate Centre	-	-	-	-	-	-
Total	2,484,005	645,024	52,762	497,741	94,521	1,838,981

Credit risk exposure by geographical segment and collateral

in HUF million		Total credit risk exposure	Collateral total	Collateralised by			Credit risk exposure net of collateral
				Guarantees	Real estate	Other	
As of 31 December 2018							
Austria		-	-	-	-	-	-
Central and Eastern Europe		2,924,408	769,828	98,983	542,582	128,263	2,154,580
Hungary		2,924,408	769,828	98,983	542,582	128,263	2,154,580
Other		-	-	-	-	-	-
Total		2,924,408	769,828	98,983	542,582	128,263	2,154,580

Credit risk exposure by financial instrument and collateral

in HUF million	Total credit risk exposure	Collateral total	Collateralised by			Credit risk exposure net of collateral	Neither past due nor credit impaired	Past due but not credit impaired	Credit impaired
			Guarantees	Real estate	Other				
As of 31 December 2018									
Cash and cash balances - demand deposits to central banks and credit institutions	14,068	-	-	-	-	14,068	14,068	-	-
Derivatives and debt instruments held for trading	117,082	-	-	-	-	117,082	-	-	-
Non-trading debt instruments at FVPL	72,434	33,230	105	32,806	319	39,204	-	-	-
Debt instruments at FVOCI	146,617	-	-	-	-	146,617	146,617	-	-
Debt instruments at AC	2,124,858	641,660	41,348	493,680	106,632	1,483,198	2,014,927	62,467	47,464
Debt securities	737,531	45	-	45	-	737,486	736,448	-	1,083
Loans and advances to banks	97,816	4,622	-	-	4,622	93,194	97,809	7	-
Loans and advances to customers	1,237,191	608,856	41,348	490,953	76,555	628,335	1,131,748	59,536	45,907
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	449,350	94,938	57,530	16,097	21,312	354,412	385,878	14,228	2,949
out of which: other commitments	46,295	15,498	3,087	2,957	9,453	30,797	-	-	-
Total	2,924,408	769,828	98,983	542,582	128,263	2,154,580	2,561,490	76,695	50,413

in HUF million	Total credit risk exposure	Collateral total	Collateralised by			Credit risk exposure net of collateral	Neither past due nor impaired	Past due but not impaired	Impaired
			Guaran-tees	Real estate	Other				
As of 31 December 2017									
Cash and cash balances – other demand deposits	1,031	-	-	-	-	1,031	1,031	-	-
Loans and receivables to credit institutions	68,672	3,739	-	-	3,739	64,933	68,657	15	-
Loans and receivables to customers	1,181,997	595,176	21,415	489,244	84,517	586,821	1,051,513	71,412	59,072
Financial assets - held to maturity	651,900	-	-	-	-	651,900	651,900	-	-
Financial assets - held for trading	122,622	-	-	-	-	122,622	120,844	-	-
Financial assets - available for sale	136,765	-	-	-	-	136,765	134,606	-	-
Positive fair value of derivatives	21,083	-	-	-	-	21,083	21,083	-	-
Contingent liabilities	299,933	46,109	31,347	8,497	6,265	253,824	277,105	20,979	1,849
Total	2,484,003	645,024	52,762	497,741	94,521	1,838,979	2,326,739	92,406	60,921

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	14,068	-	-	-	14,068
Derivatives and debt instruments held for trading	116,828	65	188	-	117,082
Non-trading debt instruments at FVPL	62,412	7,019	1,048	146	70,625
Debt instruments at FVOCI	146,617	-	-	-	146,617
Debt instruments at AC	1,715,012	188,096	61,975	923	1,966,005
Debt securities	731,963	4,486	-	-	736,448
Loans and advances to banks	88,041	-	9,768	-	97,809
Loans and advances to customers	895,009	183,610	52,206	923	1,131,748
Trade and other receivables	10,327	1,413	732	-	12,472
Finance lease receivables	30,449	4,916	1,085	-	36,450
Debt instruments held for sale in disposal groups	-	-	-	-	-
Positive fair value of hedge accounting derivatives	-	-	-	-	-
Off balance-sheet exposures	381,308	43,403	6,990	473	432,173
out of which: other commitments	40,583	4,166	1,074	471	46,295
Total	2,477,021	244,911	72,018	1,541	2,795,492

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

in HUF million	Total credit risk exposure						Thereof collateralised					
	Total	Thereof	Thereof	Thereof	Thereof	Thereof more than 180 days past due	Total	Thereof	Thereof	Thereof	Thereof	Thereof more than 180 days past due
		1-30 days past due	31-60 days past due	61-90 days past due	91-180 days past due	1-30 days past due		31-60 days past due	61-90 days past due	91-180 days past due		
As of 31 December 2018												
Non-trading debt instruments at FVPL	1,809	1,414	173	51	30	140	1,775	1,391	173	51	30	129
Debt instruments at FVOCI	-	-	-	-	-	-	-	-	-	-	-	-
Debt instruments at AC	59,543	50,614	4,495	1,266	176	2,992	49,149	44,284	3,664	929	17	254
Loans and advances to banks	7	-	-	-	-	7	-	-	-	-	-	-
Loans and advances to customers	59,536	50,614	4,495	1,266	176	2,984	49,149	44,284	3,664	929	17	254
Finance lease receivables	1,225	1,137	62	26	-	-	1,224	1,136	62	26	-	-
Trade and other receivables	1,699	1,633	66	-	-	-	-	-	-	-	-	-
Off balance-sheet exposures	14,228	13,738	361	63	55	11	485	485	-	-	-	-
Total	78,504	68,536	5,157	1,406	262	3,143	52,633	47,296	3,899	1,006	48	384

in HUF million	Total credit risk exposure						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	Total	Thereof 1-30 days past due	There of 31-60 days past due	There of 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	15	2	-	-	-	13	2	2	-	-	-	-
Loans and receivables to customers	71,412	57,135	5,569	2,221	189	6,298	30,388	26,486	2,751	692	35	423
Contingent liabilities	20,979	20,589	289	36	40	25	-	-	-	-	-	-
Total	92,406	77,725	5,858	2,257	229	6,336	30,390	26,488	2,751	692	35	423

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;
- geographical segment and coverage by loan loss allowances and IFRS 9 treatment;
- business segment and currency.

Loans and advances to customers by business segment and risk category

in HUF million	Low risk	Management at- tention	Substandard	Non-performing	Total
As of 31 December 2018					
Retail	468,395	157,176	57,685	44,787	728,044
Corporates	522,216	50,042	24,633	3,910	600,801
Group Markets	2,104	-	-	-	2,104
Asset/Liability Management and Local Corporate Centre	245	-	47	-	292
Total	992,960	207,218	82,366	48,698	1,331,241

As of 31 December 2017	Low risk	Management at- tention	Substandard	Non-performing	Total
Retail	522,974	87,525	14,064	56,825	681,388
Corporates	426,477	42,540	17,989	7,987	494,993
Group Markets	5,615	1	-	-	5,616
Total	955,067	130,065	32,053	64,812	1,181,997

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	605,346	31,543	24,068	26,036	686,994	41,050	728,044
Corporates	578,280	7,269	2,429	12,141	600,119	681	600,801
Group Markets	2,104	-	-	-	2,104	-	2,104
Asset/Liability Management and Local Corporate Centre	292	-	-	-	292	-	292
Total	1,186,023	38,812	26,497	38,177	1,289,509	41,732	1,331,241

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 (excl. collateral)	NPL collateralization ratio	
	Total	AC	Total	AC	AC	Total	AC	Total	AC	AC	Total	AC
As of 31 December 2018												
Retail	44,787	44,391	728,044	686,994	36,682	25,184	24,871	6.2%	6.5%	82.6%	56.2%	56.0%
Corporates	3,910	3,906	600,801	600,119	4,603	2,377	2,372	0.7%	0.7%	117.9%	60.8%	60.7%
Group Markets	-	-	2,104	2,104	-	-	-	0.0%	0.0%			
Asset/Liability Management and Local Corporate Centre	-	-	292	292	-	-	-	0.0%	0.0%			
Total	48,698	48,297	1,331,241	1,289,509	41,285	27,561	27,243	3.7%	3.8%	85.2%	56.6%	56.4%

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

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

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 2 coverage ratio	Stage 3 coverage ratio	POCI coverage ratio
	Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI			
As of 31 December 2018											
Retail	605,346	31,543	24,068	26,036	3,091	4,773	18,257	10,561	15.13%	75.86%	40.56%
Corporates	578,280	7,269	2,429	12,141	1,627	436	2,000	540	6.00%	82.35%	4.45%
Group Markets	2,104	-	-	-	-	-	-	-			
Asset/Liability Management and Local Corporate Centre	292	-	-	-	-	-	-	-			
Total	1,186,023	38,812	26,497	38,177	4,718	5,208	20,258	11,101	13.42%	76.45%	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 2 coverage ratio	Stage 3 coverage ratio	POCI coverage ratio
	Stage 1	Stage 2	Stage 3	POCI	Stage 1	Stage 2	Stage 3	POCI			
As of 31 December 2018											
Central and Eastern Europe	1,186,023	38,812	26,497	38,177	4,718	5,208	20,258	11,101	13.42%	76.45%	29.08%
Hungary	1,186,023	38,812	26,497	38,177	4,718	5,208	20,258	11,101	13.42%	76.45%	29.08%
Total	1,186,023	38,812	26,497	38,177	4,718	5,208	20,258	11,101	13.42%	76.45%	29.08%

The above presented NPL exposures are exclusive of any write-offs recognized 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 collateralized 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	3,588	723,510	384	525	38	728,044
Corporates	332,414	258,426	9,920	41	-	600,801
Group Markets	2,104	-	-	-	-	2,104
Asset/Liability Management and Local Corporate Centre	244	47	-	-	-	292
Total	338,350	981,983	10,304	566	38	1,331,241

in HUF million	EUR	CEE-local currencies	CHF	USD	Other	Total
As of 31 December 2017						
Retail	2,238	677,563	627	951	11	681,388
Corporates	274,659	203,989	16,302	43	-	494,993
Group Markets	2,725	2,890	-	-	-	5,616
Total	279,622	884,442	16,929	994	11	1,181,997

47.4 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 Hungary, 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 Hungary's financial position as it had no relevant positions.

Methods and instruments employed

At Erste Hungary, potential losses that may arise from market movements are assessed using the value at risk (VaR). For the VaR calculations Erste Hungary 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 Hungary 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 Pillar 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:

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

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

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

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

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 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 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 banking book and trading book

in HUF million	Total	Interest	Currency	Shares
As of 31 December 2018				
Erste Bank Hungary consolidated	1,163	1,167	8	10
Banking book	1,121	1,121	-	-
Trading book	42	45	8	10
As of 31 December 2017				
Erste Hungary consolidated	571	574	9	4
Banking book	504	504	-	-
Trading book	68	70	9	4

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 Group 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.

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	(513,560)	138,979	13,446	545,816
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)
As of 31 December 2017				
Repricing gap in HUF positions	(388,820)	95,380	74,357	606,877
Repricing gap in EUR positions	(36,587)	16,853	2,453	744
Repricing gap in USD positions	(16,477)	(2,385)	16,784	(9)
Repricing gap in CHF positions	5,478	1,749	7,262	53

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 as well as 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. Liquidity and Market Risk calculates the open FX position in the banking book, and closes the position with the trading book daily. The open foreign currency position of the trading book is subject to 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 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	2017	2018
Swiss Franc (CHF)	(819)	168
Euro (EUR)	(6,835)	1,707
Japanese Yen (JPY)	7	11
US Dollar (USD)	178	839
Other	10	43

47.5 Liquidity risk

The liquidity risk in Erste Hungary 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 bank'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 1 730 billion as of year-end 2018 (2017: HUF 1 540 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%).

With regards to own issuance, Erste Hungary Group mainly through Erste Mortgage Bank issued HUF 72,2 billion in bonds in 2018 (2017: HUF 26,5 billion)

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 Hungary 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.

The worst scenario is the severe combined idiosyncratic and market crisis (SCIM) whose length changed from 1 to 3 months. The higher outflow rates and the aforementioned longer tenor caused an average SPA deterioration of 100-150 million euro making the methodology more conservative. The reason this effect is not observable in the time series is that SPA improving actions has been taken at the end of December 2017 to offset the expected negative effects of the methodology changes. Important to highlight that the worst bucket is highly dependent on the timing of the LEAs (liquidity enhancing actions), therefore the lowest SPA figure is not always the last scrutinized bucket.

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 Hungary'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 Hungary.

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 Hungary is the FTP system.

Analysis of liquidity risk

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

Liquidity coverage ratio

Erste Hungary 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 Hungary 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	2017	2018
Liquidity buffer	843,575	856,664
Net liquidity outflow	456,458	333,881
Liquidity coverage ratio	185%	257%

Liquidity gaps

The long-term liquidity position is managed 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 amortization 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

in HUF million	2017				2018			
	< 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	(220,327)	119,026	235,188	(133,887)	(303,613)	(107,213)	591,887	(181,061)
Off-Balance Sheet Liquidity GAP	(727)	1,491	3,876	2,581	2,124	(827)	1,695	4,049

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 according to its original liquidity profile, although it can be mobilized at any time to cover the negative gaps on the short-term tenors.

Counterbalancing capacity

Erste Hungary 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
2018					
Cash, excess reserve	21 952	-	-	-	-
Other central bank eligible assets	896 391	(10 970)	(9 037)	(64 576)	(72 676)
Counterbalancing capacity	918 343	(10 970)	(9 037)	(64 576)	(72 676)
2017					
Cash, excess reserve	20,292	-	-	-	-
Liquid assets	772,148	(103)	(42,943)	(68,486)	(28,186)
Counterbalancing capacity	792,440	(103)	(42,943)	(68,486)	(28,186)

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	2 143 278	2 202 051	466 222	547 252	608 504	580 072
Financial liabilities HfT	622	622	622	-	-	-
Financial liabilities at FVPL	36 945	38 606	-	19 256	19 350	-
Financial liabilities at AC	2 105 712	2 162 823	465 601	527 997	589 154	580 072
Deposits by banks	216 365	241 749	122 307	32 672	56 966	29 804
Customer deposits	1 730 468	1 733 810	340 605	472 391	469 721	451 092
Debt securities in issue	99 237	116 359	131	20 640	53 377	42 212
Other financial liabilities	2 823	2 823	2 558	49	102	114
Subordinated liabilities	56 819	68 082	0	2244	8987	56 850
Derivative liabilities	18 740	18 740	2 764	10 292	3 160	2 523
Total on balance sheet liabilities	2 162 018	2 220 791	468 986	557 545	611 665	582 595
Contingent liabilities	314,874	314,874	314,874	-	-	-
Financial guarantees	308	308	308	-	-	-
Irrevocable commitments	314,566	314,566	314,566	-	-	-

As of 31 December 2017						
Non-derivative liabilities	1 825 748	1 859 310	292 897	360 764	740 694	464 956
Financial liabilities HFT	622	622	622	0	0	0
Financial liabilities at FVPL	37 584	40 178	63	812	39 303	0
Financial liabilities at AC	1 787 542	1 818 511	292 212	359 952	701 391	464 956
Deposits by banks	151 880	162 362	56 955	30 008	45 995	29 405
Customer deposits	1 540 898	1 544 754	234 431	324 831	606 567	378 925
Debt securities in issue	44 083	47 415	827	2 994	40 182	3 412
Subordinated liabilities	50 681	63 980	0	2119	8647	53 214
Derivative liabilities	15 162	15 162	3 327	6 833	3 319	1 682
Total on balance sheet liabilities	1 840 910	1 874 472	296 224	367 597	744 013	466 638
Contingent liabilities	299,932	299,932	299,932	-	-	-
Financial guarantees	31,710	31,710	31,710	-	-	-
Irrevocable commitments	268,222	268,222	268,222	-	-	-

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.).

47.6 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.

48) Fair value of financial and non-financial instruments

Financial instruments carried at fair value

The measurement of fair value at Erste Hungary 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 Hungary 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 recognized 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 Hungary. 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.

According to the described methodology the accumulated CVA-adjustments amounted to HUF 354 million (HUF 155 million in 2017) and the total DVA-adjustment amounted to HUF 55 million (HUF 31 million in 2017).

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 categorized 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. These include trading securities, equity instruments, IFRS9 related FV loan portfolio and mortgage bonds.

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

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

in HUF million	31.12.2017				31.12.2018			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Financial assets HFT	15 026	128 507	171	143 705	5 755	113 056	1 834	120 645
Derivatives	128	20 955	-	21 083	53	24 203	1 727	25 982
Other financial assets held for trading	14 898	107 553	171	122 622	5 702	88 853	107	94 663
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	114 899	8 024	13 843	136 765	x	x	x	x
Equity instruments	-	-	1 331	1 331	x	x	x	x
Debt securities	114 899	8 024	12 512	135 434	x	x	x	x
Financial assets at FVOCI	x	x	x	x	115 284	32 881	1 483	149 648
Equity instruments	x	x	x	x	-	-	1 483	1 483
Debt securities	x	x	x	x	115 284	32 881	-	148 165
Total assets	129 925	136 531	14 014	280 470	151 741	145 937	46 187	343 865
Liabilities								
Financial liabilities HFT	253	14 909	-	15 162	676	17 805	881	19 362
Derivatives	183	14 909	-	15 092	54	17 805	881	18 740
Other financial liabilities held for trading	70	-	-	70	622	-	-	622
Financial liabilities at FVPL	-	37 584	-	37 584	-	18 299	18 646	36 945
Debt securities issued	-	37 584	-	37 584	-	18 299	18 646	36 945
Total liabilities	253	52 493	-	52 746	676	36 104	19 527	56 307

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 categorized 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.

The table below shows the movement within Level 3 category:

in HUF million		Gains/losses profit or loss	Gains/losses OCI	Pur- chases	Sales	Settle- ments	Trans- fer into Level 3	Transfer out of Level 3	Currency translation	
	01.01.2018									31.12.2018
Assets										
Financial assets HFT	171	0	0	107	-171	-	1 727	-	-	1 834
Derivatives	0	0	0	-	-	-	1 727	-	-	1 727
Other financial assets held for trading	171	0	0	107	-171	-	-	-	-	107
Non-trading financial assets at FVPL	49 644	2 519	0	556	-	(9 848)	-	-	-	42 870
Equity instruments	970	169	0	-	-	0	-	-	-	1 138
Loans and advances	48 674	2 350	0	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)	-	-
Loans and advances	-	-	-	-	-	-	-	-	-	-
Total assets	62 687	2 519	263	663	-171	(9 848)	1 727	(11 684)	31	46 187
Liabilities										
Financial liabilities HFT	-	-	-	-	-	-	881	-	-	881
Derivatives	-	-	-	-	-	-	881	-	-	881
Financial liabilities at FVPL	-	-	-	-	-	-	18 646	-	-	18 646
Debt securities issued	-	-	-	-	-	-	18 646	-	-	18 646
Total liabilities	-	-	-	-	-	-	19 527	-	-	19 527

in HUF million	01.01.2017	Pur- chase	Sale/ Settle- ment	Gains/ Losses in other compre- hensive income	Gains/ Losses in in- come state- ment	Transfer into Level3	Transfer out of Level3	Ex- change rate ef- fect	31.12.2017
Financial assets - held for trading	1,620	171	-	-	(68)	-	(1,531)	(21)	171
Derivatives & Derivatives - hedge accounting	1,620	-	-	-	(68)	-	(1,531)	(21)	-
Financial assets - available for sale	2,041	-	(4,847)	(19)	3,769	12,981	-	(83)	13,842
Financial liabilities held for trading	-	-	-	-	(5)	-	5	-	-
Financial liabilities designated at fair value through profit and loss	12,232	-	-	-	-	-	(12,232)	-	-

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 were 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	1,727	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	41,732	Discounted cash flow	PD	0.26%-100% (5.45%)
				LGD	<u>7.39%-94% (11%)</u>

Sensitivity analysis using reasonably possible alternatives per product type

in HUF million	2018	
	Fair value changes	
	Positive	Negative
Derivatives	42	(46)
Income statement	42	(46)
Debt securities	508	(381)
Income statement	508	(381)
Equity instruments	258	(258)
Income statement	114	(114)
Other comprehensive income	144	(144)
Loans and advances	848	(6,176)
Income statement	848	(6,176)
Total	1,656	(6,861)
Income statement	1,512	(6,718)
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

2018					
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	2 086 890	2 091 917	716 138	76 393	1 299 385
Cash and balances with central bank	55 819	55 819	55 819	-	-
Debt securities - at amortised cost with credit institutions	39 467	39 748	-	33 101	6 648
Debt securities - at amortised cost with customers	697 317	704 069	660 319	43 293	457
Loans and advances with credit institutions	97 777	98 748	-	-	98 748
Loans and advances with customers	1 196 510	1 193 532	-	-	1 193 532
LIABILITIES	2 102 889	2 092 721	-	83 092	2 009 628
Deposits from banks (not subordinated)	216 365	218 289	-	-	218 289
Deposits from customers	1 730 468	1 720 182	-	-	1 720 182
Debt securities issued	103 544	103 925	-	83 092	20 832
Subordinated liabilities	52 512	50 325	-	-	50 325
2017					
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	1 865 592	1 917 702	646 894	46 677	1 224 131
Cash and balances with central bank	21 324	21 324	21 324	-	-
Loans and receivables to credit institutions	68 672	68 961	-	-	68 961
Loans and receivables to customers	1 123 697	1 150 654	-	-	1 150 654
Financial assets - held to maturity	651 900	676 764	625 571	46 677	4 516
LIABILITIES	1 838 208	1 837 056	-	41 858	1 795 198
Deposits from banks	202 560	198 730	-	-	198 730
Deposits from customers	1 540 898	1 541 759	-	-	1 541 759
Debt securities issued	44 083	45 900	-	40 595	5 305
Subordinated liabilities	50 666	50 666	-	1 263	49 403

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 amortized 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 Hungary's own credit risk is derived from buy-back levels of own issuances.

Fair value of non-financial assets

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 disclosed in the notes		10 838	10 838	-	-	10 838
Investment properties		10 838	10 838	-	-	10 838
Assets whose Fair Value is presented in the Statement of Financial Position		7 802	7 802	-	-	7 802
Assets held for sale (IFRS 5)	32)	1405	1405	-	-	1405
Repossessed assets (IAS 2)	33)	6 397	6 397	-	-	6 397

2017						
in HUF million	Note	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable market data Level 2	Marked to model based on non-observable inputs Level 3
Assets whose Fair Value is disclosed in the notes		10,347	10,347	-	-	10,347
Investment properties		10,347	10,347	-	-	10,347
Assets whose Fair Value is presented in the Statement of Financial Position		8,114	8,114	-	1	8,113
Assets held for sale (IFRS 5)	32)	1	1	-	1	-
Repossessed assets (IAS 2)	33)	8,113	8,113	-	-	8,113

49) 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
	204	186

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

The total balance charged for 2018 consists of 176 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.

50) Contingent liabilities

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

in HUF million	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 substitutes	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 37), page 69.

Legal proceedings

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

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

The level of uncertainty related to the outcome of these litigations 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.

51) Analysis of remaining maturities

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

in HUF million	17.dec		18.dec	
	< 1 year	> 1 year	< 1 year	> 1 year
Cash and cash balances	21,324	-	55,819	-
Financial assets HFT	93,138	50,567	103,661	16,984
Non-trading financial assets at FVPL	x	x	4,401	69,171
Equity instruments	x	x	-	1,138
Debt securities	x	x	-	30,702
Loans and advances to customers	x	x	4,401	37,331
Financial assets - available-for-sale	13,767	122,998	x	x
Financial assets at FVOCI	x	x	-	149,648
Equity instruments	x	x	-	1,483
Debt securities	x	x	-	148,165
Financial assets - held to maturity	117,235	534,665	x	x
Loans and receivables to credit institutions	68,671	-	x	x
Loans and receivables to customers	249,730	873,967	x	x
Financial assets at AC	x	x	415,814	1,615,258
Debt securities	x	x	83,613	653,172
Loans and advances to banks	x	x	83,582	14,195
Loans and advances to customers	x	x	248,619	947,891
Finance lease receivables	x	x	20,683	16,919
Property and equipment	-	18,947	-	8,624
Investment properties	-	-	-	10,838
Intangible assets	1	25,564	-	24,053
Current tax assets	704	-	1,480	-
Deferred tax assets	-	-	3,371	-
Assets held for sale	-	1	-	1,405
Trade and other receivables	-	-	13,000	1,114
Other assets	25,428	2,363	24,917	6,347
Total Assets	589,998	1,629,071	643,146	1,920,361
Financial liabilities HFT	10,916	4,247	13,678	5,684
Financial liabilities at FVPL	0	37,584	18,463	18,482
Debt securities issued	0	37,584	18,463	18,482
Financial liabilities at AC	647,973	1,139,570	985,039	1,120,672
Deposits from banks	86,963	115,598	151,913	116,964
Deposits from customers	557,656	983,242	811,638	918,830
Debt securities issued	3,354	40,730	18,881	84,662

Other financial liabilities	-	-	2,607	216
Provisions	4,672	4,019	1,747	5,545
Current tax liabilities	-	0	46	-
Deferred tax liabilities	-	584	144	23
Other liabilities	16,619	13,609	34,854	1,264
Total equity	-	339,278	-	357,864
Total Liabilities	680,180	1,538,891	1,053,972	1,509,535

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

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

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

The calculation is made in accordance with Hungarian regulatory requirements, conform to EU regulation, and based on consolidated IFRS. IFRS 9 transition had no adverse impact on Erste Hungary's capital.

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

in HUF million	2017	2018
Tier 1 capital before deductions	339,278	357,864
Deductions from the Tier 1 capital (-)	70,889	32,569
Tier 1 capital after deductions	268,389	325,295
Tier 2 capital	52,676	54,360
Deductions from the Tier 2 capital (-)	-3061	-
Total qualifying own funds	324,126	379,655
Risk weighted assets (base for credit risk)	1,227,477	1,255,473
Capital requirement for credit risk	98,198	100,438
thereof IRB approach	90,500	92,343
thereof standardized approach	7,698	8,095
Capital requirement for market risk	1,376	872
thereof calculated with simple approach	1,376	872
thereof from debt instruments	1,321	810
thereof from capital instruments	43	62
thereof open FX positions	12	-
Other capital requirements for credit valuation adjustment	668	727
Capital requirement for operational risk	34,536	41,145
Total base for capital requirement	1,684,729	1,789,775
Total capital requirement	134,778	204,822

53) Events after the balance sheet date

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

54) Other information

Erste Hungary'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

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

Company name	Interest of Erste Bank Hungary in % - directly or indirectly at 31.12.2017	Interest of Erste Bank Hungary 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 (USD)	0.0005%	0.0005%

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

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