BUDAPEST HITEL ÉS FEJLESZTÉSI BANK LTD

UNDER THE INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) ADOPTED BY THE EUROPEAN UNION

CONSOLIDATED ANNUAL FINANCIAL STATEMENT

31 DECEMBER 2019

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Independent Auditors' Report

To the shareholder of Budapest Hitel- és Fejlesztési Bank Zrt.

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the 2019 consolidated financial statements of Budapest Hitel- és Fejlesztési Bank Zrt. and its subsidiaries (hereinafter referred to as "the Group"), which comprise the consolidated statement of financial position as at 31 December 2019, which shows total assets of MHUF 1,531,561, the consolidated statement of profit or loss , which shows profit for the year of MHUF 11,571, and the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2019, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU (hereinafter referred to as "EU IFRSs") and those are prepared, in all material respects, in accordance with the provisions applicable to entities preparing consolidated annual financial statements in accordance with EU IFRSs of Act C of 2000 on Accounting in force in Hungary (hereinafter referred to as "the Act on Accounting").

Basis for Opinion

We conducted our audit in accordance with Hungarian National Standards on Auditing and applicable laws and regulations in Hungary. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group for the purposes of our audit of the consolidated financial statements, as provided in applicable laws in force in Hungary, "The Policy on Rules of Conduct (Ethics) of the Audit Profession and on Disciplinary Procedures" of the Chamber of Hungarian Auditors, as well as with respect to issues not covered by these, in the "Code of Ethics for Professional Accountants" issued by the International Ethics Standards Board for Accountants (the IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note 6.9, which presents the primary assessment of the Group relating to the effect of the coronavirus (Covid-19) pandemic. Our opinion is not modified in respect of this matter.

Key Audit Matters

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

Valuation of loans and advances to customers (HUF 933,911 million)

See Notes 3.1. and 4.5. to the consolidated financial statements.

The key audit matter	*How the matter was addressed in our audit*
The impairment of loans and advances to customers is considered to be a key audit matter due to the significance of loans and advances to customers. Loans and advances to customers (HUF 933,911 million) account for 61% of total assets, while impairment of loans and advances to customers amounted to HUF 48,585 million as of 31 December 2019. Without an appropriate impairment allowance the carrying amount of loans and advances to customers can either be under- or overstated. The calculation of impairment of individually significant loans and advances to customers requires an expert estimate in respect of estimating collateral values and future cash flows, and involves significant assumptions. Collective impairment is assessed by the Group using expected credit loss (ECL) models. Due to the complexity of ECL models and the significant assumptions used in such models, the calculation of collective impairment also involves significant estimation uncertainty. IFRS 9 disclosures are very likely in the focus of investors'/legislators' attention.	Our audit procedures included the following: We understood the management's decisions and the integrated controls, which ensure the impairment on loans is complete and accurate. We tested the key controls over impairment and collateral calculations, and we analysed what was discussed at the monthly Provision and Portfolio Quality Reviews. With the involvement of our IT experts we checked whether the system calculates the days in default correctly. We examined the appropriateness of data/information used in estimates. We conducted a loan review on a sample of individually significant customer loans, and based on the number of the items covered we do not expect any significant error in the remaining portfolio. Our loan review included interviews with account managers, checking client and collateral monitoring, consideration of assumptions applied by the Bank, review of impairment estimates prepared by credit risk managers and re-performance of key calculations. We reviewed the assumptions based on our professional judgement and industry knowledge. We assessed collateral values with reference to valuations performed by valuers approved by the Bank and based on the reviews performed by us. With the involvement of our financial risk management experts we evaluated the impairment models and the estimation parameters. With the help of our IT specialists we tested the system-integrated control mechanisms for provisioning and the general IT environment.

	We assessed whether the disclosures required by IFRS 9 are complete and accurate.

Other Information

The other information comprises the 2019 consolidated business report of the Group. Management is responsible for the preparation of the consolidated business report in accordance with the Act on Accounting and other applicable legal requirements, if any.
Our opinion on the consolidated financial statements expressed in the Opinion section of our report does not cover the consolidated business report.

In connection with our audit of the consolidated financial statements, our responsibility is to read the consolidated business report and, in doing so, consider whether the consolidated business report is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

Based on the Act on Accounting, we are also responsible for assessing whether the consolidated business report has been prepared in accordance with the Act on Accounting and other applicable legal requirements and expressing an opinion on this and whether the consolidated business report is consistent with the consolidated financial statements.

With respect to the consolidated business report, based on the Act on Accounting, we are also responsible for checking that the information referred to in Section 95/C and Section 134 (5) of the Act on Accounting has been provided in the consolidated business report.

In our opinion the 2019 consolidated business report of the Group is consistent, in all material respects, with the 2019 consolidated financial statements of the Group and the applicable provisions of the Act on Accounting.

There are no other legal requirements that are applicable to the consolidated business report of the Group, therefore, we do not express an opinion in this respects.

We confirm that the information referred to in Section 95/C and Section 134 (5) of the Act on Accounting has been provided in the consolidated business report.

In addition, in light of the knowledge and understanding of the Group and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the consolidated business report, and if so, the nature of such misstatement. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with EU IFRSs and for the preparation of the financial statements in accordance with provisions applicable to entities preparing consolidated annual financial statements in accordance with EU IFRSs of the Act on Accounting and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

As part of an audit in accordance with Hungarian National Standards on Auditing and applicable laws and regulations in Hungary, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

• Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

• Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

• Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

• Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.

• Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

• Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

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

Report on Other Legal and Regulatory Requirements

We were appointed by members meeting on 30 May 2019 to audit the consolidated financial statements of the Group for the financial year ended 31 December 2019. Our total uninterrupted period of engagement is 23 years, covering the periods ending 31 December 1997 to 31 December 2019.

We confirm that:

• our audit opinion is consistent with the additional report presented to the Audit Committee of the Group dated 26 March 2020;

• we have not provided to the Group the prohibited non-audit services (NASs) as set out by Article 5(1) of EU Regulation (EU) No 537/2014 and in terms of the member state derogations by the Act LXXV of 2007 on the Chamber of Hungarian Auditors, the Activities of Auditors, and on the Public Oversight of Auditors in force in Hungary. We also remained independent of the audited entity in conducting the audit.

The engagement partner on the audit resulting in this independent auditors' report is the signatory of this report.

Budapest, 26 March 2020

KPMG Hungária Kft.

Registration number: 000202

István Henye
Partner, Professional Accountant
Registration number: 005674

This is an English translation of the Independent Auditors' Report on the 2019 consolidated financial statements of the Budapest Hitel- és Fejlesztési Bank Zrt. issued in Hungarian. If there are any differences, the Hungarian language original prevails. This report should be read in conjunction with the complete consolidated financial statements it refers to.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

data in HUF M

Description	Comments	31.12.2019	31.12.2018
Cash and cash equivalents	4.1	192 059	59 023
Derivative financial assets	4.2	3 137	2 613
Securities	4.3	337 399	307 483
Loans and advances to banks	4.4	8 914	7 201
Loans and advances to customers	4.5 & 3.1	933 911	826 408
Property, plant and equipment	4.7	24 196	9 610
Intangible assets	4.7	15 743	12 929
Actual income tax receivables	4.8	323	865
Deferred tax receivables	4.8	84	246
Other assets	4.9	15 795	10 357
TOTAL ASSETS		**1 531 561**	**1 236 735**
Derivative financial liabilities	4.2	9 757	3 405
Deposits from banks	4.10	212 552	163 388
Deposits from customers	4.11	1 121 149	892 073
Provisions	4.12 & 3.1	2 199	2 245
Actual income tax liabilities	4.8	403	-
Deferred tax liabilities	4.8	69	1
Other liabilities	4.13	20 591	21 571
Total liabilities		1 366 720	1 082 683
Share capital	4.14	19 396	19 396
Reserves	4.15	145 445	134 656
Total equity		164 841	154 052
TOTAL EQUITY AND LIABILITIES		**1 531 561**	**1 236 735**

Budapest, 26 March 2020

Dr. Koppány Lélfai
Chairman of BoD & Chief Executive Officer

Keresztyénné Katalin Deák
Chief Financial Officer

CONSOLIDATED INCOME STATEMENT

data in HUF M

	Comments	2019	2018
Interest income		44 796	37 868
- of which lease interest not accounted for with effective interest rate method		*9 394*	*6 280*
Interest expense		(1 842)	(905)
Net interest income	5.1	**42 954**	**36 963**
Dividend income		-	-
Fee and commission income		45 649	39 943
Fee and commission expense		(6 688)	(6 057)
Net fee and commission income	5.2	**38 961**	**33 886**
Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)	5.3	4 302	1 877
Net trading income/(losses)	5.4	(1 755)	50
Net income/(loss) from (non-trading) financial instruments valued at FVTPL	5.5	(824)	(354)
Net foreign exchange gain/(loss)		(851)	1 491
Other operating income	5.6	4 473	5 497
Other operating expenses	5.6	(20 335)	(19 031)
Personnel expenses	5.7	(28 423)	(26 342)
Other administrative expenses	5.7	(14 572)	(15 694)
Depreciation and amortisation	5.8	(8 039)	(5 855)
Net (impairment loss)/ reversal of impairment loss on financial assets & provision	5.9	(1 625)	2 470
Profit before income tax		**14 266**	**14 958**
Income tax expense	5.10	(2 695)	(2 419)
PROFIT FOR THE YEAR		**11 571**	**12 539**

Budapest, 26 March 2020

Dr. Koppány Lélfai	Keresztyénné Katalin Deák
Chairman of BoD & Chief Executive Officer	Chief Financial Officer

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

data in HUF M

	2019	2018
PROFIT FOR THE YEAR	**11 571**	**12 539**
Other comprehensive income to be reclassified to profit/loss	**2 713**	**(1 415)**
Change in net fair value of securities valued at fair value through other comprehensive income	2 883	(2 061)
Net amount reclassified to profit/loss of securities valued at fair value through other comprehensive income	(170)	646
Income tax related to items to be reclassified to profit or loss	**(244)**	**127**
OTHER COMPREHENSIVE INCOME, NET OF TAX	**2 469**	**(1 288)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**14 040**	**11 251**
OF WHICH: - Attributable to non-controlling interest	-	-
- Attributable to the owners of the Bank	14 040	11 251

Budapest, 26 March 2020

Dr. Koppány Lélfai
Chairman of BoD & Chief Executive Officer

Keresztyénné Katalin Deák
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

data in HUF M

	SHARE CAPITAL	RESERVES breakdown			RESERVES	TOTAL EQUITY
		Valuation reserve	Retained earnings	Statutory reserves		
Balance as at 1 January 2018	**19 396**	**1 168**	**118 209**	**4 028**	**123 405**	**142 801**
Total comprehensive income						
Profit for the year	-	-	12 539	-	12 539	12 539
Other comprehensive income	-	(1 288)	-	-	(1 288)	(1 288)
Total comprehensive income	**-**	**(1 288)**	**12 539**	**-**	**11 251**	**11 251**
Transactions with equity holders						
Share issuance	-	-	-	-	-	-
Dividends	-	-	-	-	-	-
Transactions with owners	-	-	-	-	-	-
Total transactions with equity holders	**-**	**-**	**-**	**-**	**-**	**-**
Other transactions						
Transfer of retained earnings to statutory reserve	-	-	(934)	934	-	-
Total other transactions	**-**	**-**	**(934)**	**934**	**-**	**-**
Balance as at 31 December 2018	**19 396**	**(120)**	**129 814**	**4 962**	**134 656**	**154 052**
Balance as at 1 January 2019	**19 396**	**(120)**	**129 814**	**4 962**	**134 656**	**154 052**
Total comprehensive income						-
Profit for the year	-	-	11 571	-	11 571	11 571
Other comprehensive income	-	2 469	-	-	2 469	2 469
Total comprehensive income	**-**	**2 469**	**11 571**	**-**	**14 040**	**14 040**
Transactions with equity holders						-
Share issuance	-	-	-	-	-	-
Dividends	-	-	(3 251)	-	(3 251)	(3 251)
Transactions with owners	-	-	-	-	-	-
Total transactions with equity holders	**-**	**-**	**(3 251)**	**-**	**(3 251)**	**(3 251)**
Other transactions						-
Transfer of retained earnings to statutory reserve	-	-	(1 600)	1 600	-	-
Total other transactions	**-**	**-**	**(1 600)**	**1 600**	**-**	**-**
Balance as at 31 December 2019	**19 396**	**2 349**	**136 534**	**6 562**	**145 445**	**164 841**

There are no non-controlling interests in the Bank or in its subsidiaries.

Budapest, 26 March 2020

Dr. Koppány Lélfai
Chairman of BoD & Chief Executive Officer

Keresztyénné Katalin Deák
Chief Financial Officer

⟹ **Consolidated Financial Statements**

CONSOLIDATED CASH FLOW STATEMENT

data in HUF M

	2 019	2 018
Operating cash flow		
Profit before income tax	14 266	14 958
Adjustments		
Depreciation (+), Amortisation (+)	8 039	5 855
Release of impairments & provision loss (+)	1 625	(2 470)
Non-realised foreign exchange gains/losses (+/-)	851	(1 491)
Deferred tax	(14)	64
Fair value changes of securities (+/-)	442	-
Net interest income (-)	(42 954)	(36 963)
Dividend income (-)	-	-
Change in derivative financial assets (- increase, + decrease)	(524)	(243)
Change in portfolio of FVTPL securities (- increase, + decrease)	1 574	(151)
Change in loans and advances to banks (- increase, + decrease)	(1 408)	5 040
Change in loans and advances to customers (- increase, + decrease)	(105 353)	(145 481)
Change in other assets (- increase, + decrease)	(5 552)	2 363
	-	-
Change in deposits from banks, non-refinancing	4 102	40
Change in deposits from customers (+ increase, - decrease)	209 698	185 809
Change in derivative financial liabilities (+ increase, - decrease)	6 353	18
Change in other liabilities (+ increase, - decrease)	(1 566)	(1 285)
	-	-
Interest received (+)	45 767	38 751
Interest paid (-)	(1 924)	(912)
Dividends received from subsidiaries (+)	-	-
Corporate tax paid	(1 750)	(2 458)
Net cash flows from operating activities	**131 672**	**61 444**
Investment cash flow		
Investments in subsidiaries, joint ventures and associates	-	-
Investments in other enterprises	37	-
Acquisitions of property, plant and equipment	(5 592)	(2 751)
Proceeds from sale of property, plant and equipment, other derecognitions	192	176
Acquisitions of intangible assets	(6 796)	(5 350)
Proceeds from sale of intangible assets, other derecognitions	105	30
Purchase of non-FVTPL securities	(124 029)	(368 931)
Disposal of non-FVTPL securities	96 115	274 244
Dividends received from investments	-	-
Net cash flows used in investing activities	**(39 968)**	**(102 582)**
Financing cash flow		
Dividends paid	(3 251)	-
Increase of deposits from banks, refinancing	105 819	58 908
Decrease of deposits from banks, refinancing	(62 532)	(58 796)
Payments to shareholders other than dividends	-	-
Net cash flows from financing activities	**40 036**	**112**
Net change in cash and equivalents	**131 740**	**(41 026)**
Foreign currency revaluation on cash and equivalents	1 296	1 444
Cash and equivalents at the beginning of year	59 023	98 605
Cash and equivalents at the end of period	**192 059**	**59 023**

Budapest, 26 March 2020

Dr. Koppány Lélfai Chairman of BoD & Chief Executive Officer	Keresztyénné Katalin Deák Chief Financial Officer

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1 GENERAL INTRODUCTION

1.1 Introduction of Budapest Bank

Budapest Hitel és Fejlesztési Bank Zrt (hereinafter referred to as "Budapest Bank" or "Bank" or "Company" seat address: 1138 Budapest, Váci út 193, http://www.budapestbank.hu/)) was founded on 1 January 1987, at the time of the establishment of the two-tier banking system, as a joint venture of the Hungarian State, state-owned companies, private individuals and cooperatives. The Bank was privatised in December 1995 with the involvement of General Electric Capital, EBRD and ÁPV Rt. With step by step acquisitions, General Electric Capital became the Bank's majority owner, in 2012 it squeezed out the remaining minority stake. As a result, it became the Bank's 100% owner.

On 13 February 2015 GE Capital signed an agreement with the Hungarian State on the sale of the Bank. The purchase price was financially settled on 29 June 2015. Corvinus Nemzetközi Befektetési Zrt (seat address: 1027 Budapest, Kapás utca 6-12 2nd floor; www.corvinus.hu) proceeding on behalf of the State became the 100% owner, whose owner's rights were exercised by the Minister without Portfolio for the Management of National Assets in 2019. Budapest Bank Group (hereinafter referred to as the "Bank" or "Bank Group" or "Company") is fully consolidated into the consolidated report of Corvinus Nemzetközi Befektetési Zrt.

In 2012 the General Meeting changed the Bank's legal form into a private company limited by shares, at present, the Bank issues no securities. On 31 December 2019 the Company's share capital amounted to HUF 19,396 million. The Bank Group's branch network is currently comprised of 94 bank branches and the Operations Centre located in Békéscsaba, in addition to the Budapest head office.
Bank Group's average statistical staff: 3,006 in 2019; 2,952 in 2018.

The Bank is licensed to engage in comprehensive credit institution activities both in HUF and in foreign currencies. The part of the Annual Financial Statement "Consolidated Business and Non-Financial Report" contains a detailed introduction of Budapest Bank's business strategy.

Based on Section 155 of the Accounting Act, statutory audits are mandatory for the Company. Company's auditor: KPMG Hungária Kft., (address of KPMG: 1134 Budapest, Váci út 31), István Henye (card number: 005674). The Company accounted for an audit fee of HUF 86,745,000 + VAT (HUF 70,263,700 + VAT in 2018) and other fees of HUF 1,725,500 + VAT (HUF 14,336,250 + VAT in 2018) for the audit of the 2019 financial statement.

The Bank Group's 2019 financial statement is signed by Chairman of BoD & Chief Executive Officer dr. Koppány Lélfai (1082 Budapest, Baross utca 21. 4. em. 1) and Chief Financial Officer Keresztyénné Katalin Deák (1161 Budapest, Pálya utca 49).

The person responsible for supervision of the accounting and financial reporting services: Zoltán Szűcs (name at birth: Zoltán Szűcs, mother's name at birth: Terézia Deli, registration number: MK178499, official card number: 6937, areas of specialisation for registration: IFRS and finance in the register of the chartered accountants kept by the Ministry of Finance).

The Company will also publish this financial statement and the attached business report on its Internet website at www.budapestbank.hu/info/irattar/.

1.2 Introduction of subsidiaries of Budapest Bank Group

Budapest Bank provides some of its services through specialised, legally separate subsidiaries forming part of the Bank Group in which it directly holds 100% stakes.

Budapest Alapkezelő Zrt

The Bank established Budapest Alapkezelő Zrt in 1992; this subsidiary is responsible for managing the assets of investment funds and pension funds. Investment units are traded primarily in Hungary, via the branch network of Budapest Bank; however, the foreign trading of investment units – in the Czech Republic – also accounts for a material proportion of the Company's total annual sales volume. The total assets of pension funds reached HUF 123 billion, while the assets of investment funds amounted to HUF 304 billion on 31 December 2019. Within the framework of asset management, the provision of services for investment funds and pension funds is also a primary focus of the Company.

The Company is permitted to invest in the newly launched funds to facilitate the initial phases of their operation; however, it disposes any such funds within a short time of their initial operation. Accordingly, the assets managed by the Company are not consolidated into the books of Budapest Alapkezelő Zrt. The Company generates most of its revenues based on pre-fixed price levels set in fund regulations or in management contracts.

Risk management policy and activities of Budapest Alapkezelő are established together with the Bank, based on group principles. The Company constitutes a single corporate income tax group together with other members of the Bank Group.

In accordance with the Bank's liquidity and capital strategy, the Company usually distributes its annual profits to the owner in the form of dividends. Average statistical staff of Alapkezelő in 2019: 17 persons.

Alapkezelő Zrt's 2019 year-end total assets amounted to HUF 2,971 million; its share capital to HUF 500 million; its equity to HUF 2,614 million.

Seat address of Alapkezelő: 1138 Budapest, Váci út 193

Budapest Lízing Zrt.

The most important activities of Budapest Lízing Zrt, established by the Bank in 1992, are the purchase and lease of long-term tangible production assets. It is primarily engaged in providing finance leases for heavy utility vehicles, production and agricultural machinery, equipment, buses and other assets, and eventually automobiles and small utility vehicles.

According to the legislation currently in force, in addition to finance lease – both HUF and currency based; closed-end and open-end –, the Company is allowed to provide loans and advances solely for corporate customers only.

Risk policy and financing activities of Budapest Lízing Zrt are established together with the Bank, based on group principles. The Company constitutes a single VAT and corporate income tax group together with other members of the Bank Group.

The Company's lending activities are essentially financed by Budapest Bank, and few special projects refinanced by other banks are also managed.

Company's average statistical staff in 2019: 21 persons. The company's 2019 year-end total assets amounted to HUF 123,660 million; its share capital to HUF 62 million; its equity to HUF 7,406 million.

Seat address of Lízing: 1138 Budapest, Váci út 193

Budapest Eszközfinanszírozó Zrt

Budapest Eszközfinanszírozó Kft was established by the Bank in 1991. Budapest Eszközfinanszírozó Zrt was created in 2013 by renaming of SBB Zrt, where Budapest Flotta Zrt and Budapest Eszközfinanszírozó Kft were merged.

Budapest Eszközfinanszírozó Zrt as a member of Budapest Bank Group is engaged in the financing of automobiles, small utility vehicles, heavy utility vehicles, production machinery, equipment and other instruments in operating lease arrangements. The company is under joint operation with Budapest Lízing Zrt.

The Company's activities can be divided into two different divisions: the production asset financing division is now engaged in the activities formerly pursued by Budapest Eszközfinanszírozó Kft, while the fleet management division – whose business portfolio terminated in 2015 – is now only responsible for the management of Budapest Bank Group's automobile fleet taken over from the legal predecessor Budapest Flotta Zrt.

Risk management policy and financing activities of Budapest Eszközfinanszírozó Zrt are established together with the Bank, based on group principles. The Company constitutes a single VAT and corporate income tax group together with other members of the Bank Group.

The Company's lending activities are financed almost solely by Budapest Bank.

Company's average statistical staff in 2019: 22 persons. The company's 2019 year-end total assets amounted to HUF 4,246 million; its share capital to HUF 15 million; its equity to HUF 1,711 million.

Seat address of Eszközfinanszírozó: 1138 Budapest, Váci út 193

2 ACCOUNTING POLICY

The general accounting principles applied by the Bank are laid down in detail in an internal policy prescribed for financial institutions on a mandatory basis, in the Accounting Policy, which was approved by the Bank's management and reviewed by the Bank's auditor. The Bank's Accounting Policy was prepared in accordance with the IFRS standards; consequently, the fundamental principles, laid down in the IFRS Framework principles, the IAS 1 "Presentation of Financial Statements" and the IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", constitute its basis.

The policy entitled "A Budapest Bank Zrt. és Leányvállalatainak IFRS számviteli politikája és értékelési szabályzata" *[IFRS Accounting Policy and Valuation Rules of Budapest Bank and its Subsidiaries]* is summarised in the following breakdown:

2.1 General Accounting Principles
- A. Applied accounting standards
- B. Consolidation
- C. Foreign currency valuation

2.2 Accounting principles for the net income items
- D. Interest income and expense
- E. Commissions
- É. Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)
- F. Net income /(loss) from financial instruments valued at FVTPL
- G. Other operating income and expenses
- H. Income tax

2.3 Accounting principles for the statement of financial position items

2.3.1 Financial instruments

2.3.1.1 General accounting principles

2.3.1.2 Amortised cost (AC)
- I. Debt investment securities
- J. Loans and advances to customers
- K. Loans and advances to banks
- L. Financial liabilities classified into amortised cost valuation category
- M. Cash and cash equivalents
- N. Equity

2.3.1.3 Fair Value through Profit or Loss (FVTPL)
- O. Trading debt-securities
- P. Derivative transactions
- Q. Financial liabilities classified into fair value valuation category
- R. Securities valued at fair value through profit or loss on a mandatory basis
- S. Loans and advances to customers

2.3.1.4 Fair Value through Other Comprehensive Income (FVTOCI)
- T. Debt-securities for liquidity purposes
- U. Shares for investment purposes

2.3.2 Non-financial instruments
V. Leases
W. Property, plant and equipment
X. Intangible assets
Z. Inventories
AA. Other assets and liabilities
BB. Contingent liabilities and provisions
CC. Deferred tax
DD. Employee benefits

2.4 Material estimates applied by Bank Group
2.4.1 Impairment
2.4.2 Fair valuation
2.4.3 Hedging transactions

2.1 General Accounting Principles

A. Basis of preparation

The Bank Group prepared its consolidated financial statements in accordance with the standards (IFRS) of the International Accounting Standards Board ("IASB") adopted by the EU.

In relation to areas not regulated by the IFRS, the Bank Group applies the following important legislative acts; fundamentally not with respect to valuations, but in respect of disclosure and administration:

- Act 100 of 2000 on Accounting (hereinafter referred to as the "Accounting Act" or "AA")
- Act 237 of 2013 on Credit Institutions and Financial Enterprises
- Government Decree No. 250/2000. (XII.24.) on the specificities of the annual reporting and bookkeeping obligations of credit institutions and financial enterprises ("Government Decree")
- Decree No. 39/2016. (X.11.) of the National Bank of Hungary on the prudential requirements relating to non-performing exposures and restructured receivables
- Decree No. 40/2016. (X.11.) of the National Bank of Hungary on the prudential requirements relating customer and partner rating and collateral valuation.

The Bank Group publishes its full annual financial statement approved by the Board of Directors, which also contains an auditor's report, in accordance with the provisions of Chapter IX of AA, and thereby meets its statutory obligation of publication.

The Bank Group compiled these consolidated financial statements based on going concern principles.

In the consolidated financial statements (balance sheet), assets and liabilities are valued at cost value, except financial assets and liabilities valued at fair value through profit or loss and financial instruments valued at fair value through other comprehensive income.

⟹ Consolidated Notes to the Financial Statements – Accounting Policy

The Bank Group's business year coincides with the calendar year (1 January – 31 December), while the last day of the reporting period (effective date) is 31 December. The Bank Group prepares the financial statements once annually, for the statement of financial position effective date, in which the comparative information is the preceding year of the current reporting period.

As part of the financial statements, the Bank and its Subsidiaries prepare the following statements:

- Statement of Financial Position (Balance Sheet)
- Net income statement (Statement of profit and loss and other comprehensive income)
- Statement of changes in equity
- Cash flow statement
- Footnotes

The Business Report and Non-Financial Reports under AA are also prepared, which form part of this consolidated annual financial statement.

The Bank Group as first-time adopter implemented its recordkeeping in accordance with the IFRS standards since 1 January 2018 and prepared its first financial statements under the IFRS standards for the 2018 reporting year.

International Accounting Standards Board (IASB) issues new standards continuously which, depending on their status, may have a significant impact on the Bank Group's consolidated financial statements. According to the status of their entry into force, new standards can be:

- issued by the IASB and adopted by the EU effective as of 1 January 2019
- issued by the IASB and adopted by the EU, but not yet in effect
- issued by the IASB, but not yet adopted by the EU

Standards and interpretations issued by the IASB and adopted by the EU which are already in effect in relation to the current reporting period beginning as of 1 January 2019 or thereafter:

- Annual developments for the IFRS Standards, term between 2015-2017 (As a result of the IFRS Development Project, amendments have been made to some standards (IFRS 3, IFRS 11, IAS 12 and IAS 23), primarily in the interest of eliminating inconsistencies and clarifying explanations (applicable to reporting periods beginning on 1 January 2019 or thereafter). – Adopted by the EU on 14 March 2019,
- Amendment to the IAS 19 "Employee Benefits" standard – Plan amendment, curtailment or settlement – Adopted by the EU on 13 March 2019,
- Amendment to the IAS 28 "Investments in Associates and Joint Ventures" standard – Long-term interests in associates and joint ventures – Adopted by the EU on 8 February 2019,
- IFRIC 23 "Uncertainty over Income Tax Treatments" – Adopted by the EU on 23 October 2019,
- Amendment to the IFRS 9 "Financial Instruments standard"– Prepayment Features with Negative Compensation – Adopted by the EU on 22 March 2018,
- IFRS 16 "Leases" – Adopted by the EU on 31 October 2017.

According to the Bank Group's expectation, the initial application of these amendments, new standards and interpretations will not significantly affect the financial statements.

⟹ Consolidated Notes to the Financial Statements – Accounting Policy

An exception is the application of the IFRS 16 standard, which had a significant impact on the lessee primarily in connection with the rentals of office buildings and bank branches.

The IFRS 16 conversion caused significant changes in the Balance Sheet, while the impact on the net profit in the Income Statement was not significant. The reason for this is that, based on the standard, the lessee recognises a right for use of assets, while the lease liability is the liability related to the payment of the lease amortisation payments.
The Bank Group applied the modified retrospective approach to the transition to IFRS 16, meaning that it did not restate periods in the consolidated financial statements concerning 2019, but accounted for the effect of the initial application of IFRS 16 against the opening retained earnings on 1 January 2019.

The Bank applies the five-year IRS interest rate for determining the effective interest rate of lease liabilities. In relation to new contracts, it applies the five-year IRS interest rate in effect at the end of the month preceding the signing of the contract. In the event of contract amendments, if the term changes, the Bank determines a new effective interest rate, while if the contracted amount changes e.g. due to an exchange rate fluctuation, the same effective interest rate remains in effect.

The Bank estimates the remaining term of contracts concluded for an indefinite term to be 10 years. Upon the estimation of the remaining term, the Bank takes account of the full length of any extension options featured in the contracts.

The table below demonstrates the effects of the transition to IFRS 16 on the Bank Group:

data in HUF M

Description	Total
Operating lease liabilities (original contractual maturities) - 31.12.2018	5 784
- short-term contracts	(1)
+ operating lease liabilities in optional period	8 384
Total operating lease liabilities - 31.12.2018	**14 167**
Discounted financial lease liabilities - 01.01.2019	**13 348**

Right-of-use assets are capitalised in the same amount as financial lease liabilities, so neither retained earnings nor deferred tax effect arose.

Profit/loss effect of financial lease liabilities - year 2019	
- interest expense	200
- depreciation	1 975
Total profit/loss effect	**2 175**

Should the Bank Group continued to book the rented properties as operating lease during 2019, there would have been a HUF 2,091 million rental fee accounted for.

See recognition of leases in more detail in Section V of Chapter 2.3.2.

Standards and interpretations issued by IASB and adopted by the EU but not yet in effect:

- Amendments to the IFRS 9, IAS 39 and IFRS 7 standards – Interest Rate Benchmark Reform (applicable to reporting periods beginning on 1 January 2020 or thereafter),
- Amendments to the IAS 1 and IAS 8 standards – Definition of 'Materiality' (applicable to reporting periods beginning on 1 January 2020 or thereafter),
- Amendments to References to the Conceptual Framework in IFRS Standards (applicable to reporting periods beginning on 1 January 2020 or thereafter).

According to the Bank Group's expectation, the initial application of these amendments, new standards and interpretations will not significantly affect the consolidated financial statements.

Standards and interpretations issued by the IASB and not yet adopted by the EU:

- IFRS 17 "Insurance Contracts" (applicable to reporting periods beginning on 1 January 2021 or thereafter),
- Amendments to the IFRS 3 "Business Combinations" standard (applicable to reporting periods beginning on 1 January 2020 or thereafter).

According to the Bank Group's expectation, the initial application of these amendments, new standards and interpretations will not significantly affect the consolidated financial statements.

B. Consolidation

Based on the provisions of IFRS 10, the Bank prepares consolidated financial statements because as a parent company it controls multiple business units. The Bank itself established all its current subsidiaries in full, and therefore states no goodwill in its books. At present, the Bank states no non-controlling interests in the consolidated equity because it owns 100% of the business units involved in consolidation. Only the Bank's subsidiaries are consolidated currently; the Bank has no jointly managed companies or associated businesses. Upon compiling its consolidated financial statements, the Bank values all the assets and liabilities of its subsidiaries based on common group valuation principles. The valuation procedures applied by the Bank as parent company are disclosed in this financial statement. The Bank compiles the consolidated financial statement in a single currency, in Hungarian Forint. All individual statements providing the basis of these consolidated financial statements have the same effective date, which is 31 December.
The Bank eliminates its investments against the equity elements of the subsidiaries at the time of the first consolidation so that only the assets and liabilities of the subsidiaries remain in the Group's statement of financial position.
Subsequently, the Bank eliminates any revenues and expenditures arising from intercompany transactions between the Bank and its subsidiaries in the income statement. Any interim profits or losses recognised in the individual statements of financial position are eliminated from the statements of financial position and the current year net income statements. The interim profits or losses eliminated in the previous years are carried forward as a change in the equity of the Bank with no effect for the current year net income.

The Group's relevant subsidiary is responsible for managing the assets of investment funds and pension funds. The Group can invest in these funds to facilitate the initial phases of their operation; however, it disposes any such investment within a short time of their initial operation, typically within a month. Other than as referred to above, the Group generally purchases the investment units of the managed funds for liquidity purposes and typically keeps them for short periods. With these purchases it does not acquire control over the investment or other funds as they are typically publicly traded funds operating with the participation of numerous investors. Accordingly, the assets of the funds managed by the Group are not consolidated in these financial statements.

C. Foreign currency valuation

The functional currency of the financial statements is the Hungarian forint. Data in the financial statements are rounded up or down to million forints (HUF M or HUF million). The Bank Group pursues business activities almost exclusively in Hungary, and the majority of its transactions originally come into being in forints. Therefore, the functional currency used in the Bank Group's accounting systems is the Hungarian forint (HUF). The Bank Group values any non-HUF foreign currency items at the foreign exchange rate quoted by the National Bank of Hungary. The Bank Group accounts for currency revaluation difference only in case of monetary asset and liability items denominated in foreign currency. Monetary items are all cash and equivalents as well as those assets and liabilities which can only be settled with cash. Any non-monetary asset items originally denominated in foreign currencies are not revalued. These include intangible assets, real estate, machinery, equipment and inventories which are stated in the statement of financial position at cost value. Any impairments and provisions arisen in foreign currencies are revalued if the underlying transaction itself is also denominated in a foreign currency.

The Bank Group records any foreign cash, as well as bank accounts, receivables, financial instruments, securities and liabilities denominated in foreign currencies in the original currencies, which are revalued daily at the official foreign exchange rate quoted by the National Bank of Hungary. Any revaluation difference is recorded in the "Net foreign exchange gains or losses" line of the income statement.
Any foreign currency items purchased for forints are recorded in the forint equivalent amounts, and the exchange rate is determined on the basis of the amount of forints actually paid. Any cross-currency conversion items are entered in the books based on the actual cross-currency rates and are then revalued at the official exchange rate quoted by the National Bank of Hungary.

2.2 Accounting principles for the income statement items

D. Interest income and expense

Financial assets and financial liabilities

The Bank recognises interest income and expense for financial instruments by using the effective interest rate method, excluding any interest accounted for trading financial instruments and instrument valued at FVTPL. The effective interest rate is the rate which discounts the cash payments or cash receipts through the expected life of a financial instrument exactly to the gross carrying amount of the financial asset or to the amortised cost of the financial liability. The Bank estimates any future cash flows by taking into consideration all revenues and expenditures of the individual transactions as

specified in the relevant contracts. The following items have an impact on the calculation of the effective interest rate (EIR):

- Revenues from contract conclusion and amendment fees
- Revenues from loan disbursement fees + loan commitment fees + loan assessment fees
- Revenues from prepayment option and life term amendment fees
- Appraiser and notarial fees expenditures
- Agent's commissions expenditures
- Agent's commissions revenues
- Built-in insurance premiums

The Bank recognises the above so-called "amortisable items" as interest and amortises them i) either in line with the calculated effective interest ii) or linearly during the term of the financial instrument.

The Bank Group carries out the EIR method during the term in case of the following financial instruments:

- Closed-end loans to customers or banks (including LOC-type credit card receivables)
- Loans from banks (refinancing)
- Securities

The effective interest rate is determined upon the initial recognition of financial assets and liabilities, and is not altered thereafter unless:

- a new type of amortisable item arises (procedure is the same as applied at the beginning of the term, the item is amortised during the remaining term)
- re-pricing occurs in case of variable interest instruments (loans, securities).

For the financial instrument categorised into Stage 1 and Stage 2 for expected credit loss (see definitions in Comment 2.4.1), the Bank Group calculates the interest income by applying the EIR to the gross book value. In case of Stage 3 financial instruments (see definition in Comment 2.4.1), for the calculation of interest incomes the Bank Group applies the EIR to the gross book value minus impairment.

The Bank Group accounts for interest expenses in relation to financial liabilities by applying the EIR to the amortised cost of financial liabilities.

Finance lease transactions

In case of finance lease transactions the Bank Group accounts for interest revenues by applying the implicit interest rate of the lease to the net investment in the lease.

The implicit interest rate of the lease is the discount rate at the beginning of the lease which represents the present value of the minimum lease payments and the non-guaranteed residual value equalling the total of the fair value of the leased asset and the initial direct costs incurred by the Bank Group.

The Bank Group recognises finance lease interest revenues separately in the interest income line of net income statement.

E. Commissions

All revenues and expenditures arising from financial services provided by the Bank, which are not interest and are not considered in the determination of the cost value of assets and liabilities, are classified as fee and commission. These mainly include paid or received fees and commissions related to services in respect of money transfers, securities, fund management, lending, insurance and currency transactions (including currency conversion fees).

Fee and commission revenues are accounted for in two ways:

- the fees of services provided over a given period are accrued during the term of the service period. These fees include, inter alia, guarantee fees,
- “point in time” revenues charged for the provision of services (e.g. transaction charges).

Fee revenues arising from asset management
In its fund/asset management contracts, the Bank Group assumes a contractual obligation to manage the assets of a given fund. Fund/asset management contracts do not include any other services (other contractual obligations on the Group’s part). In the contracts:

- fixed commissions laid down in the Fund Management Rules are billed,
- term regarding payment is typically prompt payment, there is no financing component,
- purchase agreements do not include reimbursement obligations,
- the Bank cannot alter the amounts or timing of the revenues specified in the customer contracts.

The Bank Group’s fund management contracts only stipulate fixed fees proportionate to the net asset value.

The asset management fee income from funds and pension funds managed by the Bank Group are recorded on this line. In case of each investment and pension funds managed by the Bank Group, a fixed commission level is calculated according to the individual Fund Management Rules. Calculation of the commission is based on the daily net asset values of the funds, multiplied by the fee percentage laid down in the Fund Management Rules. Fees are billed to funds once monthly.

The Bank Group identifies the individual funds as the customers of its asset management contracts. The Bank Group accounts for all its asset management fee revenues during the given period.

É. Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)

The Bank Group recognises hereto any net profit or loss realised on financial instruments not valued at fair value through profit or loss (profit or loss on sale of loans; profit or loss on derecognition of loans in consequence of material contract amendments provided for customers, i.e. the difference of the book value of the derecognised loan and the fair value of the new loan). The Bank Group recognises the net realised gain or loss on the sale of securities not valued at fair value through profit or loss as referred to in paragraphs 2.3.1.2 and 2.3.1.4.

F. Net income /(loss) from financial instruments valued at FVTPL

The line "Net income /(loss) from financial instruments valued at FVTPL" includes all net realised profits or losses arising from the purchase or sale of financial assets valued at fair value through profit or loss and any non-realised fair value changes. It does not include the gains or losses of financial instruments valued at fair value through other comprehensive income.

The Bank Group classifies instruments into this category if it eliminates or significantly reduces any valuation or presentation inconsistency (referred to as accounting mismatch) which would have arisen if assets or liabilities are valued and the related gain or loss recognised on a different basis.
These financial instruments can be designated as trading or non-trading, but to be valued at fair value through profit or loss on a mandatory basis or determined such as at the Bank's discretion. An instrument is trading if it is purchased for the purpose of resale within a short time. Chapter 2.3.1 discloses the detailed criteria of classification, while Chapter 2.4.2 describes the fair valuation methods.

After purchase, these instruments are to be valued at fair value; in case of interest-bearing instruments, the change in the difference of the fair value and the amortised cost value is accounted for in the net income statement in the Net income /(loss) from financial instruments valued at FVTPL line. Interest revenues are accounted for in the same profit/loss line together with the fair value valuation. The Bank Group carries out fair value valuations monthly for all its instruments valued at fair value.

G. Other operating income and expenses

All costs which are not closely related to the costs of banking operations are presented in the income statement as "Other operating expenses", while all revenues which cannot be regarded as revenues derived from banking operations are presented as "Other operating income" on a gross basis.

The following material items are included herein:

- Since 2010 financial enterprises in Hungary have been obliged to pay a so-called bank tax. As the bank tax is not based on the current-year net revenue values, it cannot be regarded as an income tax under IFRS, and therefore the Bank Group recognises it as other operating expenses.

  In case of Budapest Lízing Zrt, the tax base is 6.5% of the net interest income and net fee and commission income calculated on the basis of the revenues and expenditures stated in the financial statement of the second year preceding the current year.

  In case of the Group's parent company, the base of the bank tax is the total assets stated in the financial statement of the second year preceding the current year, adjusted by the balances arising from certain interbank transactions. The rate of the bank tax is 0.15% up to HUF 50 billion, and 0.2% for the part above that limit.

  Consequently, the bank tax amounts stated in these consolidated financial statements were calculated in relation to tax bases in accordance with the Hungarian accounting standards.

⟹ **Consolidated Notes to the Financial Statements – Accounting Policy**

- In 2013 a financial transaction duty was introduced in relation to certain transaction types (cash transactions and transfers). This duty is payable by financial service providers with headquarters' in Hungary. The financial transaction duty is accounted for as other operating expense at the time of the occurrence of the corresponding business event. However, the duty on bank card transactions is accounted for in one sum at the beginning of the year and is based on the previous calendar year's payment transactions.

- The purpose of the Investor and Deposit Protection Funds is to provide partial compensation for any financial losses sustained by investors and deposit holders due to the possible insolvency of investment service providers and banks. Members pay the funds annual fees, which the Bank accounts for in the year of the financial statement.

- The Insolvency Fund set up in 2014 is financed by credit institutions and investment enterprises to ensure that the costs of any insolvency problems emerging in the financial sector are covered by the sector itself. The fund is covered from the annual fees paid by members. The Bank accounts for the fee payable to the fund in the reporting year. The Bank additionally pays mandatory statutory membership fees to several agencies proceeding as authorities, primarily to the National Bank of Hungary.

- For VAT purposes, incoming invoices can be arranged into three groups: i) the VAT on purchases solely for services subject to VAT can be deducted in full, ii) the VAT on purchases solely for services exempt from VAT cannot be deducted at all, iii) in case of purchases which cannot be clearly assigned to activities that are all subject to VAT or are all exempt from VAT, the VAT can be deducted pro rata. In this ratio the numerator is the value subject to VAT of the revenues of the VAT group created by the Bank, while the denominator is the total of revenues subject to VAT and exempt from VAT. All VAT that cannot be deducted or can only be deducted pro rata is accounted for as other operating expense.

- The Bank Group presents the derecognition gain/loss of inventories given on a lease, the net profit/loss of the disposal of real properties, machinery, equipment and intangible assets and any related impairment release in this profit/loss category.

- Initial fair value on refinancing liabilities and financial assets (see section 5.6).

- The Bank only presents state grants if there is sufficient evidence that it meets the attached conditions and will be awarded such grants.

H. Income tax

The Bank Group treats corporate income tax and local taxes as income taxes.

Local taxes form part of the profits tax in the consolidated income statement since they are not value added-based. Local taxes include the local business tax and the innovation tax.

The Bank presents in the statement of financial position deferred tax receivables and liabilities on all deductible and taxable temporary differences in accordance with the IAS 12 standard. Any changes therein are presented in the profit/loss as tax expenditures if they are related to transactions to be accounted for in the profit/loss, or as other comprehensive income if they are related to transactions to be accounted for in other comprehensive income. Deferred tax receivables are accounted for on

any deductible temporary differences, but only if sufficient taxable profits are likely to be generated against which they can be offset. The Bank Group fundamentally relies on its business plans for supporting future taxable profits. See deferred tax in detail in Chapter CC.

In Hungary the tax authority can inspect accounting records and adjust the tax levied at any time within six years of the end of any given fiscal year. Accordingly, in the event of an inspection by the tax authority, tax adjustments may occur at the Bank Group level as well. The tax authority inspected and closed the Bank's tax returns up to 2015. There was no comprehensive inspection at subsidiaries regarding the years not yet affected by the period of the statute of limitations. The Bank Group is not aware of any material tax liability in arrears which could emerge in connection with the years not yet audited by the tax authority.

2.3 Accounting principles for the statement of financial position items

2.3.1 Financial instruments

2.3.1.1 General accounting principles

a.) Initial recognition and valuation

Upon initial recognition, the Bank Group values financial assets and financial liabilities at fair value, plus or minus – if the financial assets or financial liabilities are not valued at fair value through profit or loss – the transaction charges which can be attributed directly to the issuance or acquisition of the financial assets or financial liabilities.

The Bank Group recognises in its books all financial instruments purchased or sold on the value date of the transaction as balance sheet items. Derivative financial instruments are recognised on the transaction day.

i.) Upon initial recognition, the transaction price is the best proof of fair value, meaning the fair value of the consideration given or received.

ii) If the Bank Group decides that the fair value at the time of initial recognition is different from the transaction value and the fair value cannot be proved with a price quoted on an active market for the same asset or liability, and neither is it based on a valuation technique which only uses data derived from observable markets, then the financial instrument must be valued at fair value at the time of its initial recognition, adjusting it in such a way that the difference of the fair value at the time of initial recognition and the transaction value is deferred. After initial recognition, the difference is accounted for in the profit or loss on a proportional basis during the lifespan of the instrument, but no later than when the valuation becomes fully supported with observable market data or when the transaction is closed.

iii.) If the fair value can be supported with a price quoted on an active market for the same asset or liability, or it is based on a valuation technique which only uses data derived from observable markets, the Bank Group accounts for the difference of the transaction price and the fair value in the profit or loss at the time of the initial recognition of the instrument.

b.) Classification

Upon initial recognition, the Bank Group classifies financial assets as valued at amortised cost value, at fair value through other comprehensive income or at fair value through profit or loss.

c.) Follow-up valuation

The Bank Group values its financial instruments at amortised cost value if i) the sole purpose of the business model related to the portfolio of the instrument is the collection of contractual cash flows, and ii) the contractual cash flows solely extend to principal and the interest due on the outstanding principal where principal means the fair value of the disbursed amount, while interest reflects the credit risk, funding cost, profit margin and the time value of money.

The amortised cost value according to the provisions of IFRS 9 is the initial value of the instrument, minus principal repayments, adjusted by the interest based on the effective interest rate method, and minus any impairment. The Bank Group accounts for and enters in its books interest revenues and interest expenses on the basis of the effective interest rate method defined in the chapter "Interest income and expense" in relation to the profit/loss, and determines the amortised cost value or book value of the instrument. In case of non-defaulting financial assets (stages 1 and 2), the interest revenue accounted for with the effective interest rate method and is calculated on the basis of the gross book value, while in case of impaired (defaulting – stage 3) transactions, it is calculated on the basis of the gross amortised cost value minus impairment. The impairment is updated monthly.

d-i.) Derecognition – financial assets

The Bank Group derecognises a financial asset if

- claims relating to the cash flows arising from the financial asset expire, or
- it transfers the contractual rights relating to the receipt of the cash flows arising from the financial asset in a transaction in which effectively all risks and rewards related to ownership of the financial asset are transferred.

Upon the derecognition of a financial asset, the difference between the book value of the asset (or the book value assigned to the derecognised part of the asset) and the consideration received is recognised in the profit/loss.

If the contractual terms of financial assets are modified, the Bank Group assesses whether the cash flows arising from the modified financial assets are materially different. If the cash flows are materially different, the contractual rights relating to the cash flows arising from the original financial assets ceased to exist. Any such modifications must be accounted for as derecognition of the original financial asset and the recognition of a new financial asset. In every instance the Bank Group regards a contract amendment as extinguishment if the currency of the financial asset is modified.

If the cash flows arising from a modified financial asset valued at amortised cost value are not materially different from the pre-modification contractual cash flows, the modification will not result in the derecognition of the original financial asset. In this case, the Bank Group re-calculates the gross book value of the financial asset (as the present value of the post-modification cash flows calculated at the original effective interest rate) and recognises the difference between the new and the pre-modification gross book values in the income statement as a gain or loss due to modification.

d-ii.) Derecognition – financial liabilities

The Bank Group derecognises in the books a financial liability when it has been extinguished – when the obligations defined in the contract have been redeemed –, has been cancelled or has expired.

The Bank Group also regards an instance as extinguishment if the contractual terms of a financial liability have been modified and the cash flows arising from the modified financial liability are materially (by minimum 10%) different from the pre-modification cash flows. If this condition is not met, the Bank Group still regards the contract amendment as extinguishment if the currency of the liability is modified.
In this case, the Bank Group recognises the new financial liability corresponding to the modified terms at fair value. The Bank Group recognises the difference between the book value of the extinguished financial liability and the book value of the new, modified financial liability in the profit/loss.

If the cash flows arising from the financial liability are not materially different from the pre-modification contractual cash flows, the modification will not result in the derecognition of the original financial liability. In this case, the Bank Group re-calculates the amortised cost value of the financial liability (as the present value of the post-modification cash flows calculated at the original effective interest rate) and recognises the difference between the new and the pre-modification gross book values in the income statement as gain or loss due to modification. Any fees or charges of the modification modify the effective interest rate and the amortised cost value of the financial liabilities and are amortised in the profit/loss during the remaining term.

e-i.) Impairment

At each effective reporting date, the Bank Group assesses whether its financial assets valued at amortised cost value are impaired. A financial asset qualifies as impaired if one or multiple events have occurred which have a negative impact on the estimated future cash flows of the financial asset. See detailed description of methodology of impairment in paragraph 2.4.1.

The Bank Group recognises a loss accounted for in relation to the expected credit losses of the following financial assets not valued at fair value through profit or loss:

- receivables from finance leases,
- loans and advances to customers,
- issued financial guarantee contracts, and
- issued loan commitments.

The Bank Group accounts for a 12-month expected credit loss as of the date of initial recognition in relation to financial assets in case of transactions where credit risks have not significantly increased since initial recognition (Stage 1 or Phase 1 – performing transactions). If credit risks have significantly increased since initial recognition (Stage 2 or Phase 2 – underperforming loans) or the transaction becomes impaired (Stage 3 or Phase 3 – impaired, non-performing transactions), a lifetime expected credit loss is accounted for.

Lifetime expected credit loss: The expected credit loss arising from possible non-performance events during the expected life of the financial instrument.

12-month expected credit loss: part of the lifetime expected credit loss; the expected credit loss which may arise from possible non-performance events related to the financial instrument within 12 months of the effective date of the financial statement.

The Bank Group applies this valuation principle to receivables from finance leases and loans and advances to customers.

In case of loans and advances to customers and finance leases, the Bank Group does not avail itself of the option, under IFRS9 5.5.10, of regarding certain financial instruments as low-credit-risk financial instruments.

e-ii.) Valuation of expected credit loss

Expected credit losses are determined as follows:

- *Financial assets which are not impaired at the effective date of the financial statement*: the Bank values the expected credit losses on a combined basis with the aid of different models
- *Financial assets impaired at the effective date of the financial statement*: difference of the gross book value and the present value of the estimated future cash flows
- *Undrawn loan commitments*: present value of the difference between the contractual cash flows due to the Bank Group if the loan commitment holder draws on the loan and the cash flows expected by the Bank Group in the event of the drawing of the loan
- *Financial guarantee contracts*: the amount expected to be paid to the holder for reimbursing its credit loss, minus the amounts which the Bank Group expects to receive from the holder, the debtor or any other third party.

e-iii.) Recognition of expected credit losses in the statement of financial position

The Bank recognises expected credit losses as:

- impairment decreasing the gross book value in case of financial assets valued at amortised cost value
- provisions in case of financial guarantee contracts and loan commitments

e-iv.) Write-off

Loans and debt instruments are written off (partly or fully) if the Bank Group does not reasonably expect the recovery of the entirety or a part of the financial asset. This is generally the situation if the Bank concludes that the debtor does not have sufficient revenues to generate a cash flow to repay the amount to be written off. At the same time, the financial assets to be written off may also constitute the subject-matter of liquidation processes.

Financial instruments are presented in the financial statements in the following categories and according to the following valuation principles:

2.3.1.2 Amortised cost (AC)

The Bank values instruments falling into the following categories at amortised cost value:

I. Debt investment securities

Based on a business model, the Bank classifies securities into this category if the goal is to collect contractual cash flows. The Bank typically holds these securities until maturity in every instance. Contractual cash flows only extend to principal and interest. These securities can be both fixed and both variable interest. Prepayment and the alteration of the term are not typical occurrences, and in the event of payment deferral there is no interest-free period. The discount or premium are treated as not part of the accumulated interest when securities are purchased below or above face value.

J. Loans and advances to customers

Based on the Bank Group's principal activity, loans provided for retail, corporate and credit institution customers are classified into this category. The purpose of the business model of instruments classified into this category is to collect contractual interest and the disbursed principal. The Bank Group classifies a credit product into the amortised cost valuation category if the interest on the loan only covers the time value of money, the associated credit risk and a profit margin. See also Section "S" for the FVTPL classification of loans.

K. Loans and advances to banks

Loans and advances represent items related to activities with other credit institutions such as time deposits placed with other banks.

L. Financial liabilities classified into amortised cost valuation category

This category includes deposits from customers, deposits from banks and from the central bank (loro accounts, loans received, refinancing funding), and supplier payables.

M. Cash and cash equivalents

In this category the Bank recognises highly-liquid securities with a maturity of less than three months (or with a remaining term of less than three months at the time of purchase) which can therefore be converted into cash within a short time. This category also includes cash in hand, bank accounts held at other banks (nostro accounts) and overnight deposits.

N. Equity

The Bank recognises as equity the principal placed by the owners at the Bank's disposal and the after-tax profits left with the Bank. The equity consists of the share capital, capital reserve, retained earnings, accumulated other comprehensive income, and statutory reserves.
The Bank recognises the components of the equity in the statement of financial position at book value. The Bank has no repurchased own shares and has not adjusted its share capital or issued shares recently. Any transaction charges, net of tax effects, attributable to equity transactions (e.g. issuance of own shares) would directly decrease the equity**.**
Dividend cannot be paid from the *capital reserve*. The current-year after-tax profit is included in the *retained earnings*. The Bank accounts for any dividends payable to the owners as a reduction in the retained earnings. It is accounted for in the period when the dividend is approved, i.e. the owner earns the right to dividends. In the *accumulated other comprehensive income,* the Bank recognises those net income items which have not yet been realised and therefore cannot be recognised as part of the annual profit. At present, it only includes the cumulative balance of the fair valuation differences of liquidity purpose securities valued at fair value through comprehensive profit or loss. In the *statutory reserves*, the Bank states the general reserves transferred from the retained earnings as regulated by the relevant statutory legislation. The Bank creates no further reserves beyond the mandatory, statutory reserves amounting to 10% of the after-tax profit.

2.3.1.3 Fair Value through Profit or Loss (FVTPL)

If according to the business model the goal is not to collect contractual cash flows, but to earn a profit or gains from sale or trading, or the contractual terms result in future cash flows which are not exclusively payments of principal and the interest due on the outstanding principal amount, then in every instance the financial instrument must be valued at fair value through profit or loss. No impairment is accounted for in case of financial assets classified into this category. The Bank Group carries out fair value valuations monthly in respect of all its instruments valued at fair value. The fair value valuation difference is recognised as a net sum in a separate income statement line in the current-year income statement. The fundamental principles of fair valuation are introduced in Chapter 2.4.2.

The Bank values the instruments in the following categories at fair value through profit or loss:

O. Trading debt-securities

Securities purchased for trading purposes to realise profits in the short term are classified into this category. Securities purchased on behalf of customer orders and sold on to customers are also classified into this category.

P. Derivative transactions

The Bank primarily concludes derivative transactions for hedging purposes. Occasionally, the Bank also may conclude trading derivative transactions to realise short-term profit. The notional amounts of the derivative transactions are recorded as off-balance-sheet items at the time of their inception.

Derivative financial instruments are accounted for at fair value on the deal day and are subsequently also revalued at fair value.

Any change in the fair value of derivative financial instruments is accounted for in the income statement. The difference between the fair value and cost value of each derivative transaction is stated as an asset or liability, depending on its nature.

Derivative transactions which are made to hedge the positions of the Bank's risk management positions, but do not qualify as hedge accounting transactions under the IFRS 9 standard are classified for trading derivatives. They are therefore presented at fair value, and any non-realised profit or loss is stated directly in the income statement. The details of hedge accounting are introduced in Chapter 2.4.3.

The Bank is engaged in the following derivative transaction types: forward, currency rate swap (CRS), interest rate swap (IRS), cross-currency interest rate swap (CIRS). The Bank Group has no embedded derivative products.

Q. Financial liabilities classified into fair value valuation category

The Bank designates a financial liability as a liability to be valued at fair value through profit or loss if this improves consistency and helps to avoid any accounting mismatch. Currently, there are no such instruments.

R. Securities valued at fair value through profit or loss on a mandatory basis

Instruments of this type are e.g. shares listed on a stock exchange.

S. Loans and advances to customers

The Bank Group classifies loans provided for customers into the AC or FVTPL valuation categories on the basis of the business model test and the so-called Solely Payments of Principal & Interest (SPPI) test which is carried out individually for each loan product group. The Bank Group classifies a loan product into the amortised cost valuation category if the interest on the loan solely covers the time value of money, credit risk and a profit margin, and the loan principal represent the fair value of the disbursed principal. The loans are classified into the FVTPL category if the following criteria are not met:

- The purpose of lending is the collection of contractual cash flows.
- The contractual cash flows solely represent principal and interest.
- The business purpose of the loans is not future sale, despite the fact that the Bank Group regularly sells bad credit portfolios as part of its collections activities.
- In the event of prepayment, modification of the maturity date and restructuring, the prepayment fees are not material (typically 2-3%).
- In the event of variable interest, the interest rate moves parallel, with the change in the designated reference interest rate, into the same direction and the frequency of the fixing of the interest rate coincides with the interest periods.
- The Bank Group records any unpaid principal and interest as overdue receivables.
- In the event of deferred payment, there is no interest-free period, or it is not significant.

At present, those loans are classified into the FVTPL category where the interest does not solely include time value, credit risks and a profit margin and this is also confirmed by an SPPI test (e.g. family housing benefit-subsidised "CSOK" loans or Baby Expecting loans).

2.3.1.4 Fair value through other comprehensive income (FVTOCI)

If according to the business model the business purpose is the collection of contractual cash flows and, in given circumstances the sale of the asset, and the contractual cash flows only cover principal and the interest thereon, then the financial instrument must be valued at fair value through other comprehensive income. The instruments classified into this category based on the business model serve two functions: on one hand, the collection of contractual cash flows, and on the other, the management of daily liquidity. The securities classified into this category can be sold at any time to maintain liquidity. The individual securities are classified into business models based on the expected frequency and volume of sales for liquidity reasons.
The interest relating to financial instruments falling into this category is accounted for with the effective interest method.
In case of debt-instruments, the Bank Group transfers the amount of valuations accounted for in other comprehensive income to the current-year profit/loss (typically in case of sale).

The impairment rules also apply to financial instruments classified into this category if their credit risks are not negligible. Any credit impairment is accounted for in the valuation reserve (OCI) against the impairment loss.

The Bank Group fair values the following instruments through other comprehensive income (FVTOCI):

T. Debt-securities for liquidity purposes

Contractual cash flows only extend to principal and interest. Prepayment and maturity modifications are not typical. These may be securities bearing both fixed and variable interest. In case of variable interest, the interest rate moves parallel with the change of the designated reference interest rate, in the same direction.

U. Shares for investment purposes

In case of shares for investment purposes, the Bank Group did not elect the option to designate any such instruments for valuation through other comprehensive income.

2.3.2 Non-financial instruments

V. Leases

The Bank Group as lessor

The Bank Group presents finance lease receivables in "Loans and advances to customers" valued at amortised cost value in the statement of financial position.

The Bank Group as lessor classifies those agreements as lease receivables, when the lessor transfers the rewards of an asset to the lessee against the payment of a fixed amount and for a fixed term. Lease transactions can be finance or operating lease transactions.

If substantially all risks and rewards of ownership are transferred through the transaction as set forth in the IFRS 16 standard, the Bank Group treats the transaction as a finance lease.

In case of a finance lease transaction, at the beginning of the lease, the Bank Group as lessor recognises lease receivables in the amount of the net lease payments. The net lease payments are the present value of the total of future minimum lease payments and the guaranteed and non-guaranteed residual value, discounted by the implicit interest rate of the lease (see definition in Chapter 2.2. D). Any costs at the beginning of the lease transaction which are directly attributable to the agreement, such as agent's commissions, contract conclusion and amendment fees and appraisal fees, adjust the cost value of the lease receivables and are accounted for during the term.

After the initial recognition of finance lease receivables, the principal part of the lease fees paid reduces the amount of the lease receivables, while the interest part is accounted for as interest income (see Chapter 2.2. D). Any impairment accounted for during the period decreases the book value of lease receivables.
The Bank Group applies the same rules to the impairment of lease receivables as for other financial assets (see more detail in paragraph 2.4.1).

Leases where substantially all risks and rewards of ownership remain with the Bank Group are classified as operating leases. The asset leased continues to remain in the Bank Group's books. The lease fees received are accounted for linearly in the profit/loss during the relevant period.

At present, the Bank Group does not pursue operating lease transactions under the criteria of the IFRS 16 standard.

The Bank Group as lessee

Based on IFRS 16, in case of leases where substantially all risks and rewards of ownership remain with the lessor and are not transferred to the Bank Group (earlier operating lease), at the beginning of the lease transaction the Bank and its Subsidiaries recognise right-of-use assets which they present in the balance sheet line where the underlying assets would belong, and they state in the Comments which balance sheet lines also contain right-of-use assets. At the end of 2019, in the statement of financial position, such assets are only featured in the "Property, Plant and Equipment" line (rented real estate). The cost value of a right-of-use asset is the initial value of the relevant lease liability, the value of any already paid lease fees and any other direct ancillary costs. As the non-deductible VAT part of the payable lease fees emerges in several instalments during the term (e.g. monthly), it is not capitalised.

After recognition, all right-of-use assets are valued at cost value decreased by any accumulated depreciation and any recognised accumulated impairment loss.

In case of lease transactions with short terms and the lease of low-value underlying assets and of intangible assets as underlying assets, the Bank and its Subsidiaries do not apply the relevant rules of IFRS 16.

W. Property, plant and equipment

The Bank recognises an incurred expense as a tangible asset if the purchased asset serves the Bank's activities directly or indirectly for a term of more than one year, the economic benefits associated with the item will probably flow to the Group and the cost can be measured reliably.

The Bank records tangible assets in its books at cost value. The cost value includes the purchase price, plus any non-deductible VAT, customs duties and official charges, minus any discounts; costs necessary for bringing an asset to working condition for its intended use, and expected costs of dismantling of the asset if any. The Bank does not regard bank funding related to the acquisition because lending forms part of its credit institutions activities, and therefore the interest thereon is not capitalised.
The Bank recognises office equipment below the limit of HUF 15,000 as other material expenses at the time of acquisition. All individually purchased assets with a cost value of less than HUF 100,000 are entered in the fixed assets register and are depreciated in one sum immediately after recognition. The Bank and its subsidiaries can purchase low-value assets of the same type in group and capitalise and depreciate them in group during their useful life.

Following capitalisation, the Bank values all its tangible assets according to the cost value model. Based on this, the book value of assets is the cost value, minus the accumulated depreciation and accumulated impairment accounted for, to be adjusted on a mandatory basis by any costs capitalised subsequently if the value of the cost to be capitalised exceeds 25% of the cost value of the asset. Property, plant and equipment cannot be revalued due to this valuation model.
During depreciation, the Bank writes off the cost of an asset monthly during its useful life, pro rata for each day, with the straight-line method, as operating expense. The Bank determines the useful life of each asset group which is reviewed and adjusted if necessary, annually. In case of refurbished assets, if the value of the refurbishment exceeds 25% of the cost value of the refurbished asset, the useful life is reviewed (in particular, for investments carried out in rented properties). Investments made in rented properties are written off based on the expiry of the rent agreement.

The Bank recognises the following asset groups and depreciation rates based on the typical expected useful life as follows:

Description	**Life**
Buildings	50 years
Land	n/a
Networks (computer, telecommunications)	12.5 years
Investments in rented properties	as per rental agreement
Furnishings	7 years
Security equipment	7 years
Bank and office equipment	7 years
Personal computers	3 years
Other computer equipment	3 years
Mobile telephones	2 years
Automobiles	5 years

Based on experiences, for most of the Bank's tangible assets, the residual value is not material. Therefore, the Bank only determines residual value for these assets if their expected value is above HUF 1 million. For automobiles, a residual value is always determined based on the future value quoted at the time of purchase.
The Bank derecognises a tangible asset or intangible asset from its book if it disposes the asset or no longer expects any further benefit from the use of the assets. The profit/loss effect of disposal is recognised in the profit/loss as net operating income or expense, which is the difference of the proceeds of the sale and of the book value of the disposed assets.

X. Intangible assets

The Bank recognises those incurred expenses as intangible assets which relate to the purchase or production of an identifiable, non-tangible asset over which the Bank has a controlling right, which is expected to generate economic benefits, and whose cost value can be determined reliably. An intangible asset is identifiable if it can be sold independently or arises from contractual or legal rights. The cost of the acquired assets is the acquisition cost which is determined based on the initial valuation rules applicable to Property, plant and equipment, with the difference that dismantling costs are never capitalised in the cost value of intangible assets. The Bank regards only in-house designed software as internally developed intangible assets. The cost value of self-developed software products includes all costs which incurred directly in the interest of their development during the development phase, such as the costs of materials and services, wage costs and incidental contributions, expert fees (e.g. project management costs), consulting fees and licensing costs.

Z. Inventories

Upon acquisition, inventories are recorded at cost value which includes the purchase price, any non-deductible VAT, import customs duties and transportation costs. Any foreign currency difference at financial settlement does not adjust the purchase price. The repossessed collaterals the Bank holds with the purpose of resale and carries it at the value of which the Bank excepted as the offset for its receivable. Upon the repossession of a leased asset, the Bank records the asset in the inventories at a

forced sale market price as determined by an appraiser. If the cost value of an inventory is not expected to be recovered (because of damage or obsolescence), the Bank writes down the inventory to the net realisable value.

AA. Other assets and liabilities

Other assets and liabilities not qualifying as financial instruments are recorded at transaction price. The transaction price is the amount stated in the relevant contract, invoice or any other accounting certificate.
The Bank recognises among these items receivables due from employees, liabilities due to the State Budget (taxes and social security liabilities), non-interest-type accruals and various active and passive accounts.

Customer contracts typically relate to sales of leased assets at the end of the term, in case of which:

- the leased asset is transferred to the buyer directly by the lessee (typically within the framework of a repurchase agreement with the supplier),
- the term of payment is in general prompt payment and there is no financing component,
- the purchase agreements typically do not stipulate returning or reimbursement obligations,
- the sale is based on a guaranteed repurchase agreement concluded with the original supplier of the leased asset.

The Bank Group does not make decisions in connection with customer contracts to modify the amount and timing of the contract revenues.

BB. Contingent liabilities and provisions

The Bank recognises provisions in its statement of financial position if, in consequence of an event in the past, it has an obligation of an uncertain amount whose value can be reliably estimated and the fulfilment of the obligation is probable to result in an outflow of resources. The Bank regards the obligation as probable if the probability exceeds 50%.

Provisions are made for:

- Guarantees provided as part of lending activities
- Credit lines provided as part of lending activities
- Pensions and severance pay
- Pending litigation
- Restructuring events
- Other provisions

An obligation is recognised as a contingent liability if it is
(a) *a possible obligation* which arises from events in the past and whose existence will only be confirmed by the occurrence or non-occurrence of one or several uncertain future events not entirely under the Bank's control; or
(b)*an existing obligation* which arises from events in the past, but where
(i) the settlement of the liability is not likely (with a probability of less than 50%) to result in an outflow of resources; or
(ii) the amount of the obligation cannot be reliably measured.

The Bank Group does not recognise contingent liabilities in the balance sheet; however, the following contingent liabilities are stated in the books separately:

- Financial guarantees provided to customers
- Credit line liabilities
- Contingent liabilities related to pending litigations

All guarantees provided are accounted for as contingent liabilities. The received guarantee fees are stated as the initial balance sheet values of the financial guarantees provided. The value of expected losses arising from guarantees is stated as provisions in subsequent valuations.

The amounts of undrawn credit lines which exist based on customer contracts are also stated as contingent liabilities. The Bank determines the initial balance sheet value of credit lines as zero, while the value of expected losses as a follow-up value. For contingent liabilities related to loans falling into the performing (stage 1) and underperforming (stage 2) portfolios the Bank accumulates provisions with regard to a credit conversion factor estimated with statistical methods. The Bank applies a 100% drawdown probability rate to contingent liabilities related to non-performing (impaired) loans (stage 3). Similar to the impairment of loans, the Bank estimates the expected cash flows, calculates the present value and accounts for the provisions as the difference between the value of the contingent liabilities and the present value of the recoveries.

Provisions made for pending litigations are determined individually for each case based on a legal expert opinion as the most likely amount the Bank is expected to be required to pay on the basis of the probability of losing the lawsuit and the value of litigation.

Provisions determined for early-retirement pensions and severance pay should cover the amounts to be paid in the future due to staff reductions approved and communicated during the business year.

Provisions made for guarantees and credit liabilities are presented in compliance with IAS 37 standard.

CC. Deferred tax

A taxable temporary difference is recognised in respect of an asset or liability if the related tax is not payable during the current period, but in the future. In case of a deductible temporary difference, the tax payable in the current period becomes deductible in the future.
The Bank prepares its balance sheets for financial reporting and tax purpose monthly, and the differences between the two balance sheets are classified into the classes of permanent and temporary difference on an itemised basis. A permanent difference has no deferred tax implication, while temporary differences are designated as taxable or deductible.

A temporary difference may typically arise in the following cases:

- Depreciation charge of assets (due to difference between the tax and accounting depreciation rates)
- Impairments of certain assets (due to deductibility/non-deductibility from income tax)
- Certain provisions (due to deductibility/non-deductibility from income tax)

The following may additionally result in deferred tax receivables:

- Accrued loss (unused negative tax base)
- Unused tax credit

The Bank offsets its current period tax receivables and tax liabilities against one another. If based on the available business plans no future taxable income will be available against which the deferred tax receivables could be offset, tax receivables will be recognised only to the extent that tax benefit can be realised.

The tax balance sheet necessary for determining any deferred tax is prepared in accordance with the tax regulations in force at the balance sheet date. Deferred tax receivables and liabilities are determined all times at the corporate tax rate in force or published. The Bank does not apply an average tax rate, because pursuant to the corporate tax law in force, the corporate tax rate is flat which is not likely to change in the future.

DD. Employee benefits

If an employee is entitled to a benefit payable in the future which is likely to be paid, the Bank recognises an employee benefit liability, and the relevant cost will be accounted for in respect of the period when the employee completed the service.
Accruals for short-term benefits are only recognised in the statement of financial position if they relate to the current period, but payment is only expected to take place during the following period. Those provisions created for benefit elements are recognised as long-term benefits which are expected to be paid beyond a period of 12 months following the completion of service.

As part of this, the Bank recognises accrual- or provisions-type liabilities in the following cases:

- salaries, premiums, bonuses, other benefits and contributions provided as short-term benefits if they are paid after the current period (accrual),
- salaries and contributions due for unused, accumulated vacation provided as a short-term benefit if they are likely to be paid or used after the current period (accrual),
- the percentage of loyalty bonuses provided as long-term benefits (jubilee bonus) which is likely to be payable in the future (provisions),
- the percentage of deferred remuneration provided as a long-term benefit (business plan-performance-driven bonuses) which is likely to be payable in the future (accrual),
- expected severance pay (provisions).

The Bank states its employee benefit liabilities to be recognised in the statement of financial position at the value which the Bank is expected to pay in connection with the settlement thereof. The estimation of liabilities relating to unpaid leave assumes that the entire unused leave will be taken or paid for during the following period. The Bank recognises service time as part of the loyalty bonus programme. The Bank rewards 5, 10, 15, 20, 25 and 30 years of service. The Bank calculates its future payment liability according to an actuarial calculation method, with regard to fluctuation, age and service time, on the basis of historical data, for each employee, and then discounts this value.
The Bank’s shares are not listed on any stock exchange and have no market price. For the purposes of compensatory performance measurement, the Bank calculates a theoretical share price. The performance-driven remuneration of management is determined based on the calculated share price. 50% of the performance-linked remuneration is long-term, deferred remuneration. The deferral period used by the Bank is 3 years during which the deferred part is paid in instalments of 33%-33.5%-33.5%.

The rate of the reward actually payable in each year is subject to the employee's current-year evaluation and to the Bank's performance.
Severance pay is recorded when its future payment is obliged and communicated with the persons concerned.

2.4 Material estimates applied by Bank Group

2.4.1 Impairment

According to the provisions of IFRS 9, the Bank accounts for impairments on the basis of changes in the expected credit risks in respect of financial assets valued at amortised cost value (loans, bank deposits, securities) and financial assets valued at fair value through comprehensive profit or loss (securities). The Bank applies different methods for determining impairments on loans, bank deposits and securities.

Based on the expected credit losses and the extent of credit risks, in accordance with IFRS 9, the Bank distinguishes three stages. In case of Stage 1 – performing – assets, a twelve-month credit loss is accounted for since the initial recognition. If the expected loss significantly increases after initial recognition (stage 2 – underperforming assets) or there is objective evidence suggesting non-performance (stage 3 – non-performing assets), an expected lifetime credit loss is accounted for.

Criteria relating to a significant rise in credit risks since initial recognition can be the following:

- a significant deterioration in rating/probability of default compared with the initial rating/probability of default (1.5% increase in PD or a four-notch rating deterioration),
- transfer to watch list – in case of corporate loans,
- extent of delay – at the worst from 30 days,
- certain collection indicators – in case of retail loans, even below a delay of 30 days certain collection activities indicate an increased credit risk (the correlation between early collections and subsequent default probabilities determines which collection actions the Bank should consider in case of different products).

PD: probability of default; notch: risk rating category

Indicators showing an increase in the above credit risks determine the stage 2 classification of financial instruments and also the accounting for expected lifetime losses, instead of expected losses for a period of 12 months. If the conditions of a stage 2 classification do not exist, the instrument can be transferred back to stage 1 category.

The Bank does not avail itself of the option under IFRS9 5.5.10; this would allow the Bank to regard certain financial instruments as low-credit-risk instruments.

If, during valuation at the reporting date, default is identified for an individual transaction based on objective evidence, the transaction is transferred to stage 3.

A loan is regarded as non-performing and transferred to stage 3 category (and regarded as impaired) if the following criteria are met at the valuation date:

- there is a legal procedure under way against the customer or any member of the company group (liquidation, bankruptcy, forced deregistration, etc.),

- the Bank declared a transaction of the customer or any member of the customer group as successful fraud,
- the customer or customer group has a terminated deal,
- the customer or any member of the customer group is under collections management,
- the number of days in delay:
  - exceeds 30 days in case of corporate customers,
  - exceeds 60 days in case of micro-customers,
  - exceeds 90 days in case of automobile financing customers,
  - exceeds 90 days in case of mortgage and unsecured retail transactions,
- individual factors in case of retail loans: private bankruptcy, deceased customers, successful fraud, revoked execution proceedings in case of mortgage transactions affected by void related litigations.

Individual impairments are only calculated for corporate non-performing loans if there is objective evidence. This, irrespective of the limit, covers the portfolio of the corporate division (not including automobile financing) and managed by the Bank's collections unit.
In determining individual impairments, the Bank estimates the expected future cash flows related to the given instrument which also includes the expected recovery from the available collateral, with regard to an optimistic and a pessimistic scenario. Weighting the scenarios with different probabilities of occurrence, the credit loss is the difference of the present value of the gross book value and the estimated future cash flow, discounted by the original effective interest rate.

Impairment losses are recognised in respect of securities and interbank receivables based on individual deliberation.

For all other financial instruments the Bank values the expected credit loss on a collective basis with different models.
Instruments are grouped on a product basis, breaking down the portfolio into sub-segments for each product group so that instruments with similar characteristics are placed into a single group.

The Bank divides its portfolio into the following products/sub-segments:

- mortgages
- automobile loans:
  - retail
  - corporate
- credit cards
- current accounts
- personal loans and sales finance
- corporate loans:
  - revolving
  - closed-end
  - micro-loans
- leases

For retail products, there is further segmentation into delay categories, currency at disbursement and portfolios with a delay of more than 90 days in case of forced HUF conversion of currency loans.
For the corporate portfolio, the Bank creates different pools based on risk ratings (OR, Obligor Rating).

Expected loss = PD (probability of default) * LGD (loss given default) * EAD (exposure at default)

PDs are point-in-time estimates, measured on the basis of 12-month default rates with time windows of 2 to 4 years; in case of retail portfolios transition matrices, while of corporate portfolios survival-type models are used.

For the purposes of the stress test, the Bank takes into consideration the macro-economic indicators and assumptions such as changes in GDP, inflation, unemployment rate, base rate and earnings. The Bank builds prospective macro-economic information into the PD estimate with adjustments. One of the scenarios is a base course, while the second scenario is a stress course, the stress test macro scenario of the Bank. During the weighting of scenarios, the base course dominates.

In case of corporate loans, the lifetime PD estimate is the probability of default on the entire lifetime of the transaction based on cumulative PD curves measured for periods of 1 to 4 years in the different pools, considering the economic lifetime of the transaction.

In case of retail loans, the Bank calculates the lifetime PD estimates by raising the matrices used for the measurement of the 12-month PDs to the power.

The loss rate is the LGD used in capital models, not including the downturn factor and indirect costs.

The exposure at default (EAD) is calculated as the amount of the balance sheet exposures and off-balance-sheet exposures, multiplied by the credit conversion factor. The credit conversion factor shows, based on empirical figures, the proportion of the off-balance-sheet items to be drawn (calculated mainly for revolving and credit card products).

The Bank does not use a separate model for the portfolios of restructured loans; however, restructured retail loans cannot be transferred to a category better than stage 2 within 24 months of the date of restructuring. Most of the corporate restructuring takes place in portfolios managed by collections, based on individual arrangements.

As a result of new regulations adopted by the National Bank of Hungary, the Group will introduce certain changes regarding the definition of ‘default’. As soon as the revised definition is used for internal risk management purposes, the Group is planning to apply the same to measuring credit losses and identifying financial assets with significantly increased credit risks or with compromised credit ratings. As expected, the Group will introduce the new definition during the business year closing on 31 December 2020 and will probably recognise this as a change in accounting estimates. The application of a new ‘default’ definition could cause a rise in the portfolio of financial instruments classified into the Stage 2 and Stage 3 categories. At present, the Group is unable to quantify the impact of this change on the amount of the expected credit losses displayed in the financial statements; however, based on the work already completed, this impact is not likely to be material.

Impairments of securities and loans to banks

The Bank classifies all its securities and loans to banks serving liquidity (FVOCI) and investment (AC) purposes into the stage 1 category, and keeps this rating as long as, based on the issuer's credit rating, the securities can be regarded as investment-grade (i.e. the Bank regards these securities as low-credit-risk securities). This is determined based on the credit ratings published by credit rating institutions (S&P, Fitch, Moody's) with respect to issuers in cases where such ratings are available. The Bank regards the securities as investment-grade if the issuer's credit rating is BBB or Baa3 or better.

If external credit ratings are not available, the Bank's internal credit rating is used for determining whether a given security is investment-grade or not.

If at the reporting date a security cannot be regarded as investment-grade, the Bank transfers the security to the stage 2 or stage 3 category and the impairment is made based on partner rating information and the extent of the delay. In stage 2 and stage 3 the Bank determines a lifetime expected loss.

For quantifying the impairment, the amortised cost value is multiplied by the PD percentage driven by the customer rating of the issuer of the security and a currency-dependant LGD percentage.

Securities and loans to banks are transferred to the stage 2 category when the instrument is in arrears for more than 30 days, while the issuer of the instrument is rated by external credit rating agencies better than "CCC+", "Caa1", or if the issuer is rated lower and the delay is less than 30 days. An instrument is transferred to the stage 3 category if the instrument is in arrears for more than 90 days, or if the instrument is in arrears for between 30 and 90 days, and the issuer of the instrument is rated for "CCC+", "Caa1" or lower.

2.4.2 Fair valuation

The Bank values the financial instruments listed in paragraphs 2.3.1.3 and 2.3.1.4 at fair value. These can be effectively *securities, derivative transactions and loans to customers.* Additionally, the Bank carries out fair valuation for disclosure purposes.

Fair value per definition is the cash received upon the sale of an asset or paid upon the settlement of a liability on the basis of a transaction concluded between a market player and the Bank under the usual market terms and conditions at the time of valuation. The data and valuation procedures used for fair valuation determine which level of the fair value hierarchy the applied method belongs to. If valuation is carried out solely based on observable data, it is level 1 of the hierarchy. If observable data is available indirectly, it is level 2 of the hierarchy. If material non-observable data can be used during fair value assessment, it is level 3 fair valuation.

Level 1 data is the price of the asset or liability quoted on its active market. An active market is a market where transactions relating to the asset or liability are carried out with sufficient frequency and in sufficient numbers in order for the market to supply continuous pricing information.
Level 2 data is the price of a similar asset quoted on the asset's active or non-active market, or any other observable data of the asset (e.g. yield curves, interest rates, credit spreads). Data derived from active market data, too, qualifies as level 2 data.

Level 3 data is determined, in every instance, to a significant degree based on assumptions, but must reflect pricing and risks on the market.

The Bank values *securities* by using active market prices, meaning level 1 and 2 input data. The Bank purchases securities at market price, and so there is no initial fair value difference. In case of government bonds, the market price used in the follow-up valuation is the buy rate published by Államadósság Kezelő Központ Zrt (ÁKK) every day in the afternoon. In case of debt-securities issued by other financial institutions, the order of prices used, are: selling price, closing price, theoretical price. In case of non-liquid bonds, the Bank uses the prices available from the Varitron, Bloomberg and Reuters systems, or theoretical prices. In case of treasury bills, the Bank regards the daily average rate of the Budapest Stock Exchange as the market price; in the absence of such a rate the Bank uses a theoretical price. Theoretical prices are calculated and yield curves are estimated from ÁKK data with the spline method.
The fair value difference is recorded for the securities portfolio in the profit/loss monthly on a gross basis.

In case of *investment fund units,* the Company regards the net asset value of one unit published daily by investment funds multiplied by the number of investment units at Alapkezelő as the fair value of a given investment fund. As all the investment funds from which the Company purchases investment units are open-end funds traded continuously, on a daily basis, the Company regards the published net asset value as the quoted market price (level 1 input of fair valuation).

For the fair valuation of *derivative transactions,* the Bank uses both market data and adjusted market data. In case of these transactions, the price applied for valuation is the price which the Bank would use if it were to close the given transaction at the moment of valuation, i.e. the deal price of a reverse transaction relating to the remaining life of the transaction to be valued. Upon valuation the Bank estimates the price at which it would be able to close the given transaction on the market and compares it with the deal price of the original transaction. In case of forwards and foreign exchange swaps, the Bank generates this closing price by adding the swap points to the price of the day (which is determined by the interest difference of the two currencies of the derivative), thereby creating a market futures price. The current-day fair value is the difference of the deal price and the market forward price of the transaction – calculated from the total of the current-day foreign exchange closing rate and the current-day closing FX swap points –, multiplied by the face value of the transaction. The profit/loss effect of multiple forward transactions concluded with individual customers is hedged by a large amount of single forward transaction. The Bank uses one-to-one hedge for high value customer forward deals by concluding reverse transactions with the same maturities and amounts as the given customer transactions. In case of these related transactions, the Bank does not use hedge accounting and does not prepare hedging documentation, consequently, it does not link together the customer and the offsetting transactions in the accounting records.

The fair value of interest swaps is calculated through the discounting of future cash flows, using the appropriate yield curve. The valuation system estimates the unknown cash flows of the variable leg of IRSs and CIRSs with the help of the yield curves which is used both to calculate the forward interest rates and for discounting.

Certain interest-subsidised loans are valued at fair value based on the SPPI test described in paragraph 2.3.1.3 S. The fair value is valued in two steps. First, all future cash flows are discounted at a market reference interest rate, and then this value is adjusted by the change in the fair value attributable to credit risks.

For disclosure purposes the Bank Group determines the fair value as the present value of the estimated future contractual cash flows of financial instruments where the discount rate is an interest rate compiled from observable market interest rates adjusted by the risk of default.

2.4.3 Hedging transactions

The Bank offsets the fluctuating net income effects of the fair value and the cash flow changes of certain financial instruments through hedge transactions and related hedge accounting.

The Bank establishes a hedge relationship on the basis of the provisions of IFRS 9 if i) every leg of the hedge pair is a transaction identifiable and matched against one another, except for the so-called portfolio-based macro-hedges, ii) the hedging efficiency requirements are met and iii) hedge documentation is available and up-to-date. The Bank terminates an existing hedge if any of the three criteria is not satisfied or the hedge expires. At present, the Bank hedges only receivables with fixed interest (macro-hedge).

Only derivative transactions are designated as hedge instruments. The Bank does not designate option-type derivative transactions as hedge items. If forward contracts are selected as hedge instruments, the entirety of the forward transactions is involved in the hedging transaction. The Bank can involve both entire financial instruments and a pro-rata part into a hedge relationship to match the maturity dates of the hedge and hedged transactions as close as possible. The Bank can designate individual items or a group of items as hedged items.

The Bank prepares hedging documentation for the day of the establishment of the hedge relationship. The documentation contains the purpose of the hedge relationship, the ID codes, the terms and conditions of the hedged and hedge transactions, the risk intended to be hedged and the method for measuring hedging efficiency. The Bank assesses hedging efficiency on the day of the creation of the hedge pair and monthly thereafter, at the end of the month. Assessment methods used: dollar-offset and scenario analysis (changing the interest rates of the transactions under the terms and conditions by +/-50 basis points). The Bank regards a hedge relationship as effective if there is an economic relationship between the hedged and the hedge items (interest rates or foreign exchange rates move between the hedging transaction and the underlying transaction in the same way in the opposite directions) and the hedge effectiveness is at a pre-fixed required level.

The Bank macro-hedges the changes in the fair value of multiple products valued at amortised cost (at present: mortgage, corporate loans, automobile loans and leases with fixed interest) through interest rate swaps (pay-fixed receive-variable IRS). In each product type, the reference interest rate of the credit products bearing variable interest is the BUBOR, while in the long term the BUBOR also affect the pricing of products bearing fixed interest. Therefore, the Bank pulls into group and hedges only those assets which share the same risk exposure, i.e. homogeneous from the respect of the risk hedged.

The fair value of the loans included in the hedging is measured by discounting the cash flows of the transactions. For the calculation of this value the Bank uses a so-called hypothetical transaction; each parameter of this transaction is identical to that of the original loan, except the interest rate, instead of which it uses the fixed rate of the IRS. Upon the valuation at fair value of the instruments included in the hedge relationship, the Bank only considers the impacts attributable to interest risk, while excluding the effect of credit risk of customers.

In accordance with the IAS 39 carve-out rules, the Bank measures efficiency both retrospectively and prospectively. For portfolio hedging, there is effectiveness between the hedging and the underlying transactions if, according to the scenario analysis, upon shifting the interest curve in either direction

the relative percentage of changes in the fair values of the hedged and hedging transactions falls between 80 and 125%.

Any changes in the fair value of derivatives designated as effective hedging transactions are accounted for in the same profit/loss line with the adjustment of the fair value of the underlying transaction. This is true even if the hedged item is otherwise valued at amortised cost value. The non-effective part of the hedging transaction is recorded directly in the net income.

3 RISK MANAGEMENT

Banking activities are exposed to numerous risks. The Bank regards risks as a fundamental feature of its banking service and treats them inherent to its business activities. The Bank operates a system which precisely measures, appropriately manages and limits risks. The most significant risks affecting the Bank are as follows:

3.1 Credit risk

Credit risk is the possibility of a loss which the Bank may sustain if the borrower becomes insolvent or fails to meet its payment obligations on time. The Bank pursues credit risk management on the basis of an underwriting, monitoring and collateral management process.

Underwriting

Upon underwriting, the Bank rates all its retail and corporate customers based on statistical or expert assessment models. The Bank Group applies multiple authorisation levels for proper risk management. As a general rule, the customer's rating, the risk appetite and the value of the collateral determine the appropriate decision-making level.

Monitoring

The Bank operates a transaction-level and portfolio-level monitoring mechanism in order to be able to operate a loan rating system which complies with the statutory regulations, and to promptly identify any exposures and customers who are unable or are likely to become unable to meet their contractual obligations in the future.

Collateral – credit risk mitigation

The Bank primarily expects the repayment of loans from revenues derived as part of the customer's normal course of business, but to cover the risks of non-repayment, the Bank requests customers to supply collateral. The range of collateral items that the Bank accepts may vary from segment as well as for each process and product type, but the fundamental principle is that the collateral must be enforceable and realisable. In case of property and tangible collateral, assets are valued based on expert appraisals, analytical records are kept of all collateral items and these must be insured during the entire term of the loan.

Expected credit loss, impairment

Relying on the above processes, the Bank accounts for impairments in respect of expected credit losses in accordance with the provisions of IFRS 9 and the methodology defined by Budapest Bank (see in Chapter 2.4.1) on a monthly basis.

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3.1.1 Loans and advances to customers by ratings and non-performing portfolio

The Bank accounted for the following impairment amounts in respect of the rating stages defined in IFRS 9 and its non-performing portfolio:

data in HUF M

	Stage 1	Stage 2	Stage 3	FVTPL loans*	Other receivables	Total
2019 closing balance						
Gross balance of loans and advances to customers	808 759	96 592	47 778	24 340	5 027	982 496
Of which non-performing portfolio	-	-	*47 778*	-	-	*47 778*
Impairment of loans and advances to customers	5 061	5 983	37 541	-		48 585
Net balance of loans and advances to customers	**803 698**	**90 609**	**10 237**	**24 340**	**5 027**	**933 911**
2018 closing balance						
Gross balance of loans and advances to customers	755 886	53 603	68 701	3 851	5 984	888 025
Of which non-performing portfolio	-	-	*62 477*	-	-	*62 477*
Impairment of loans and advances to customers	5 145	3 006	53 466	-	-	61 617
Net balance of loans and advances to customers	**750 741**	**50 597**	**15 235**	**3 851**	**5 984**	**826 408**

FVTPL* means loans valued at fair value.
See definitions of Stages 1, 2, 3 (and States 1, 2, 3) in paragraph 2.4.1.
During 2019, the Bank reclassified mortgage loans which qualified as defaulted at the time of the statutory HUF conversion of loans in 2015, but which have since started performing from Stage 3 to Stage 2; therefore, the Stage 3 portfolio is the same as the defaulted portfolio.

In the opening balance, the non-performing portfolio accounts for 7% of the total portfolio. In the closing balance this percentage fell to 4.9%.

At the Bank Group the portfolio of restructured receivables amounted to HUF 49,745 million on 31 December 2019 and to HUF 61,541 million on 31 December 2018, respectively.

3.1.2 Movements of allowances made for impaired loans and advances to customers

In 2019 the following impairment allowance movements occurred between the different rating stages which include not only possible reclassifications, but also movements arising from new loans and the cessation loans:

data in HUF M

Description	Stage 1	Stage 2	Stage 3	Total
Balance as at 1 January	**5 146**	**3 005**	**53 466**	**61 617**
Growth from formation and purchase	2 365	1 256	2 440	6 061
Decrease from derecognition	(767)	(259)	(12 050)	(13 076)
Change from change in credit risk (net)	-	-	-	-
- Classification did not change	(1 185)	(401)	(2 411)	(3 997)
- Reclassification from Stage 1	(609)	2 350	2 725	4 466
- Reclassification from Stage 2	110	(1 227)	1 012	(105)
- Reclassification from Stage 3	1	1 259	(2 094)	(834)
Change from modification not resulting in derecognition	-	-	6	6
Decrease from write-offs and cancellations	-	-	(5 553)	(5 553)
Balance as at the end of reporting period	**5 061**	**5 983**	**37 541**	**48 585**

The reclassifications between stages in the table above show not only the effect of reclassification, but also the changes in impairments in consequence of the reclassifications.

Derecognition decrease of HUF 9,556 million is related to release of sold loans, while HUF 38 million increase arise from foreign currency revaluation, and these do not affect the net impairment loss stated in section 6.9.
The derecognition of the gross value of cancelled and written-off loans and the amount of other impairment of receivables were recognised in the income statement line “Net (impairment loss)/ reversal of impairment loss on financial assets & provision” at HUF 5,189 million. The table above does not include these items.

Sold and written-off loans are not part of any legal proceedings.

3.1.3 Changes to Provisions

Similar to loans and advances to customers, the Bank makes provisions for off-balance-sheet credit risks and other contingent liabilities pursuant to the rules of IFRS 9 and IAS 37:

31.12.2019 data in HUF M

Contingent liabilities	Gross	*Provisions details* Stage 1	Stage 2	Stage 3	IAS 37	Total provisions
Undrawn lines of credit and guarantees	337 376	460	337	259		*1 056*
Other contingent liabilities (including lawsuits)	1 968	-	-	-	1 143	*1 143*
Total contingent liabilities	**339 344**	**460**	**337**	**259**	**1 143**	***2 199***

31.12.2018 data in HUF M

Contingent liabilities	Gross	*Provisions details* Stage 1	Stage 2	Stage 3	IAS 37	Total provisions
Contingent liabilities						
Undrawn lines of credit and guarantees	343 770	462	201	290	-	*953*
Other contingent liabilities (including lawsuits)	1 393	-	-	-	1 292	*1 292*
Total contingent liabilities	**345 163**	**462**	**201**	**290**	**1 292**	***2 245***

In the table above, the amount stated as "gross" represents the maximum available credit line or the maximum amount payable by the Group in connection with financial guarantee contracts. In case of other contingent liabilities, the "gross" amount is the estimated maximum amount payable by the Group.

The table below shows the movements of provisions:

Movements of provisions

31.12.2019 data in HUF M

Description	Lines of credit and guarantees	Litigations	Other provisions	Total
Opening balance	**953**	**499**	**793**	**2 245**
Increase	766	200	119	1 085
Use	-	-	-	-
Release	(663)	(217)	(251)	(1 131)
Closing balance	**1 056**	**482**	**661**	**2 199**

31.12.2018 data in HUF M

Description	Lines of credit and guarantees	Litigations	Other provisions	Total
Opening balance	**871**	**1 081**	**658**	**2 610**
Increase	678	52	174	904
Use	-	(280)	(36)	(316)
Release	(596)	(354)	(3)	(953)
Closing balance	**953**	**499**	**793**	**2245**

3.1.4 Types of loans and advances to customers and related collateral

Most of the loans and advances to customers which are secured with collateral are presented in the schedule at collateral value, the unsecured loans presented on face value:

31.12.2019 data in HUF M

Description	Gross credit portfolio	Collateral					Total collateral
		Assignment	Guarantee and suretyship	Mortgage	Assets	Security deposit	
Unsecured retail loans	99 202	-	-	-	-	-	-
Secured retail loans	312 864	1 930	1 049	287 826	67 663	-	358 468
Corporate loans and leases	541 063	5 552	68 442	157 892	120 098	20 075	372 059
Other receivables	5 027	-	-	-	-	-	-
Receivables valued at AC	**958 156**	**7 482**	**69 491**	**445 718**	**187 761**	**20 075**	**730 527**
Loans valued at fair value	24 340	-	17 744	6 722	-	-	24 466
Total	**982 496**	**7 482**	**87 235**	**452 440**	**187 761**	**20 075**	**754 993**

31.12.2018 data in HUF M

Description	Gross credit portfolio	Collateral					Total collateral
		Assignment	Guarantee and suretyship	Mortgage	Assets	Security deposit	
Unsecured retail loans	87 920						-
Secured retail loans	276 265	2 131	1 249	242 376	14 358	4	260 118
Corporate loans and leases	514 005	7 206	48 590	153 051	154 556	30 504	393 907
Other receivables	5 984	-	-	-	-	-	-
Receivables valued at AC	**884 174**	**9 337**	**49 839**	**395 427**	**168 914**	**30 508**	**654 025**
Loans valued at fair value	3 851	-	-	4 968	-		4 968
Total	**888 025**	**9 337**	**49 839**	**400 395**	**168 914**	**30 508**	**658 993**

3.1.5 Concentration of loans and advances to corporate customers by sectors

The Bank’s credit portfolio is properly concentrated by sectors at the end of each reporting period:

Period	Agriculture	Processing	Construction	Trade	Transport	Other
31.12.2019	7%	22%	8%	27%	11%	25%
31.12.2018	9%	20%	7%	27%	12%	25%

3.1.6 Impairment of cash and equivalents, securities and loans and advances to banks

data in HUF M

	Total	Stage 1 FVTOCI	Stage 1 AC
Impairment of liquid assets			
Opening balance	(1)	-	(1)
Increase from origination and purchase	(4)	-	(4)
Decrease from maturity and sale	1	-	1
Change in impairment for Stage 1 liquid assets	-	-	-
Effect of change in foreign currency rate	-	-	-
Closing balance	(4)	-	(4)
Impairment of securities			
Opening balance	(22)	(5)	(17)
Increase from origination and purchase	(46)	(45)	(1)
Decrease from maturity and sale	8	1	7
Change in impairment for Stage 1 securities	4	(1)	5
Effect of change in foreign currency rate	-	-	-
Closing balance	(56)	(50)	(6)
Loans and advances to banks valued at amortised cost value			
Opening balance	(1)	-	(1)
Increase from origination and purchase	-	-	-
Decrease from maturity and sale	1	-	1
Change in impairment for Stage 1 receivables	-	-	-
Effect of change in foreign currency rate	-	-	-
Closing balance	-	-	-

See definitions of Stage 1, Stage 2 and Stage 3 in paragraph 2.4.1.

Abbreviations:
AC: amortised cost value
FVTOCI: valued at fair value through other comprehensive income.

3.2 Liquidity risk

Liquidity risks are managed by the Bank Group centrally through applying standard rules. The purpose of liquidity risk management is to provide access to sufficient funding with which the Bank Group is able to meet its business goals and financial obligations, at reasonable costs, both in normal and critical operating environments. The risk management framework system was developed partly based on legal regulations and partly on the guidelines defined by the Management.

The Bank Group defines its liquidity risk appetite through prime liquidity indicators and limits assigned thereto:

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- In case of short-term liquidity stress tests, meeting the minimum 30-calendar-day survival period requirement
- Reaching the minimum level (100%) of the European Union's Liquidity Coverage Ratio (LCR)
- Reaching the minimum level (100%) of the net stable funding ratio (NSFR)

In case of certain assets, the Bank Group uses thresholds, exceeding the thresholds result in an early warning. In addition to its liquidity limit system, the Bank Group also operates a variety of monitoring mechanisms. These mechanisms support the tracking of liquidity risks, draw attention to negative trends, and enable the Bank Group to better comply with its liquidity risk profile.

Liquidity buffers provide the Bank Group with available liquidity with which it is able to cover its short-term liquidity needs which may arise in critical situations. The Bank Group carries out regular as well as case-to-case stress tests to assess the development of the Bank Group's liquidity in different scenarios.

The Bank Group seeks to develop a financial structure which is as independent as possible and is based to a significant extent on the collection of customer deposits. Various refinancing from banks also constitute a major part of the Bank Group's funding.

The table below shows the future maturities of financial receivables and liabilities as well as of derivative transactions on the basis of contractual maturities, or where not applicable, on the basis of the so-called deposit maturity model in relation to 31 December 2018 and 2019:

data in HUF M

Breakdown by maturity - 31 December 2019	Perpetual/ Matured/Sight	within 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	beyond 5 years	Total
Cash and cash equivalents	28 673	163 386	-	-	-	-	**192 059**
Securities	3 466	524	6 125	73 722	246 999	18 990	**349 826**
Loans and advances to banks	8 614	300	-	-	-	-	**8 914**
Loans and advances to customers	69 919	39 423	58 046	265 946	417 089	260 275	**1 110 698**
Total	**110 672**	**203 633**	**64 171**	**339 668**	**664 088**	**279 265**	**1 661 497**
Deposits from banks	416	2 297	6 925	40 209	111 099	60 463	**221 409**
Deposits from customers	21 353	513 695	21 283	60 289	501 288	5 103	**1 123 011**
- of which finance lease liabilities	*-*	*-*	*227*	*1 764*	*8 502*	*5 103*	***15 596***
Total	**21 769**	**515 992**	**28 208**	**100 498**	**612 387**	**65 566**	**1 344 420**
Derivative financial assets	-	45 013	8 861	17 486	17 922	6 193	**95 475**
Derivative financial liabilities	-	45 401	8 790	19 693	21 967	6 143	**101 994**
Total	**-**	**(388)**	**71**	**(2 207)**	**(4 045)**	**50**	**(6 519)**
Undrawn lines of credit and guarantees	65 135	13 230	41 707	149 341	63 397	4 566	**337 376**

In accordance with the NBH's guidelines, the Bank changed the expected maturity model of sight deposits; as a result, the percentage of deposits with a maturity of less than 1 month has increased significantly compared to deposits with longer maturities.

data in HUF M

Breakdown by maturity - 31 December 2018	Perpetual/ Matured/Sight	within 1 month	1 - 3 months	3 months - 1 year	1 - 5 years	beyond 5 years	Total
Cash and cash equivalents	48 024	10 999	-	-	-	-	**59 023**
Securities	5 341	6 344	333	31 511	271 066	9 601	**324 196**
Loans and advances to banks	4 225	2 976	-	-	-	-	**7 201**
Loans and advances to customers	81 643	47 185	52 835	244 878	345 496	194 551	**966 588**
Total	**139 233**	**67 504**	**53 168**	**276 389**	**616 562**	**204 152**	**1 357 008**
Deposits from banks	469	5 069	7 281	45 956	76 696	32 195	**167 666**
Deposits from customers	20 902	64 401	34 124	61 644	711 364	-	**892 435**
Total	**21 371**	**69 470**	**41 405**	**107 600**	**788 060**	**32 195**	**1 060 101**
Derivative financial assets	-	12 616	4 801	15 554	19 972	5 952	**58 895**
Derivative financial liabilities	-	12 784	4 408	16 390	21 112	4 435	**59 129**
Total	**-**	**(168)**	**393**	**(836)**	**(1 140)**	**1 517**	**(234)**
Undrawn lines of credit and guarantees	64 073	11 002	61 189	156 019	48 353	3 134	**343 770**

3.3 Interest rate risk in banking book

An interest rate risk is a risk where the value of financial instruments changes in response to the fluctuations of market interest rates. The Bank attempts to match assets with liabilities with similar interest and amortisation terms to minimise interest risks in relation to the Bank Group's entire statement of financial position. The Bank develops the composition of its interest-bearing assets and liabilities in a way as to ensure that short-term assets are in harmony with short-term liabilities, and that the interest changes of long-term assets and the related long-term liabilities vary parallel.

While complying with the conservatively defined risk limits, the Asset-Liability Management may undertake a tactical open position if opening a non-neutral position verifiably supports the Bank's profitability goals best and interest trends are considered long-lasting.

Based on standard yield curve stress scenarios, the Bank Group defines its acceptable interest rate risk tolerance level in line with the acceptable relative change of interest income and principal.

The table below summarises the Bank's open positions arising from interest repricing in the maturity structure of assets and liabilities:

31.12.2019 data in HUF M

Repricing gap table Banking book	0 - 1 month	1 - 3 months	3 - 6 months	6 months - 1 year	1 - 2 years	2 - 3 years	3 - 4 years	4 - 5 years	beyond 5 years
Cash and cash equivalents	192 059	-	-	-	-	-	-	-	-
Securities	3 466	5 973	2 629	64 394	84 591	18 996	51 893	85 931	19 526
Loans and advances to banks	8 914	-	-	-	-	-	-	-	-
Loans and advances to customers	326 554	167 059	61 936	47 328	74 338	63 776	50 357	44 901	97 662
	530 993	**173 032**	**64 565**	**111 722**	**158 929**	**82 772**	**102 250**	**130 832**	**117 188**
Deposits from banks	(54 221)	(5 431)	(55 334)	(11 845)	(39 183)	(16 227)	(11 115)	(6 782)	(12 414)
Deposits from customers	(497 440)	(81 785)	(37 897)	(38 313)	(64 467)	(83 766)	(79 916)	(237 565)	-
	(551 661)	**(87 216)**	**(93 231)**	**(50 158)**	**(103 650)**	**(99 993)**	**(91 031)**	**(244 347)**	**(12 414)**
Off-balance-sheet receivables	99 140	83 959	227 874	7 444	7 610	10 387	62 856	15 519	12 595
Off-balance-sheet liabilities	(56 346)	(56 708)	(75 744)	(15 822)	(36 049)	(39 673)	(87 458)	(82 488)	(77 692)
	42 794	**27 251**	**152 130**	**(8 378)**	**(28 439)**	**(29 286)**	**(24 602)**	**(66 969)**	**(65 097)**
Discrete gap	**22 126**	**113 067**	**123 464**	**53 186**	**26 840**	**(46 507)**	**(13 383)**	**(180 484)**	**39 677**

⟹ Consolidated Notes to the Financial Statements – Statement of Financial Position

In accordance with the NBH's guidelines, the Bank changed the expected repricing model of sight deposits; as a result, the percentage of deposits with a maturity of less than 1 month has increased significantly compared to deposits with longer maturities.

31.12.2018

data in HUF M

Repricing gap table Banking book	0 - 1 month	1 - 3 months	3 - 6 months	6 months - 1 year	1 - 2 years	2 - 3 years	3 - 4 years	4 - 5 years	beyond 5 years
Cash and cash equivalents	59 023	-	-	-	-	-	-	-	-
Securities	11 465	-	8 382	16 020	74 447	69 456	63 255	54 749	9 709
Loans and advances to banks	7 201	-	-	-	-	-	-	-	-
Loans and advances to customers	331 397	126 763	97 239	38 195	53 270	48 412	42 946	29 981	58 205
	409 086	**126 763**	**105 621**	**54 215**	**127 717**	**117 868**	**106 201**	**84 730**	**67 914**
Deposits from banks	(17 353)	(6 951)	(39 865)	(31 508)	(25 131)	(19 661)	(10 640)	(6 733)	(5 546)
Deposits from customers	(185 321)	(76 915)	(44 180)	(41 315)	(73 854)	(122 248)	(108 223)	(240 017)	-
	(202 674)	**(83 866)**	**(84 045)**	**(72 823)**	**(98 985)**	**(141 909)**	**(118 863)**	**(246 750)**	**(5 546)**
Off-balance-sheet receivables	40 576	133 501	171 613	41 231	20 838	11 207	10 411	62 851	2 423
Off-balance-sheet liabilities	(58 047)	(144 017)	(103 600)	(23 945)	(15 376)	(30 788)	(15 130)	(63 008)	(41 291)
	(17 471)	**(10 516)**	**68 013**	**17 286**	**5 462**	**(19 581)**	**(4 719)**	**(157)**	**(38 868)**
Discrete gap	**188 941**	**32 381**	**89 589**	**(1 322)**	**34 194**	**(43 622)**	**(17 381)**	**(162 177)**	**23 500**

The Bank measures interest risks by conducting scenario analyses, as well as using stress tests. These also form part of the Bank's capital requirement calculation models under Pillar 2. The table below summarises the possible effects of financial instruments on profits/losses and capital, assuming a shift in the yield curve by 200 basis points.

data in HUF M

Sensitivity (0% floor)	**Capital sensitivity**		**Profit sensitivity**	
	+200 bp	**-200 bp**	**+200 bp**	**-200 bp**
31.12.2019				
HUF	(113)	(333)	3 725	(1 746)
EUR	435	28	175	17
Other currencies	31	(119)	83	(71)
31.12.2018				
HUF	(1 019)	(1 033)	2 151	(1 591)
EUR	1 674	(151)	343	(80)
Other currencies	109	(242)	75	(119)

There is a fundamental global reform under way regarding the main reference interest rates with the aim of replacing (or reforming) the IBOR with alternative, near risk-free reference rates. In respect of the Group's financial instruments, there are no major exposures to interbank reference rates (interbank offer rates, IBOR) that would be replaced or reformed as a consequence of this market-level initiative. According to the Group's expectations, the IBOR reform will not cause significant operating, risk management or accounting effects in its operations.

3.4 Foreign currency risk

The Bank's goal is to minimise any non-intended end-of-day open foreign currency positions and to effectively manage intra-day position with regard to profitability criteria as well.

The Bank defines its currency risk tolerance level through limits applicable to open foreign currency positions. The Bank Group operates intra-day position and stop-loss limits as well as overnight position limits to ensure that open trading foreign currency positions do not exceed the fixed reasonable limits.

During daily banking operations, Treasury manages foreign currency positions generated by customer transactions as well as positions opened for trading purposes by not exceeding open position risk limits.

The Bank's open positions by currencies were as follows on 31 December 2019:

31.12.2019 data in HUF M

Currency	Balance sheet net open positions	Spot positions	Net futures positions	Net open positions by currencies
USD	(11 845)	389	11 436	(20)
CHF	(2 427)	-	2 435	8
CAD	(1)	-	-	(1)
GBP	(1 419)	(29)	1 435	(13)
DKK	(5)	1	-	(4)
SEK	(11)	15	-	4
NOK	4	-	-	4
AUD	-	-	-	-
JPY	(2)	-	-	(2)
RON	52	-	(35)	17
EUR	(3 351)	716	2 714	79
CZK	1	5	-	6
PLN	(17)	14	-	(3)

In light of the Bank's minimal open foreign exchange positions, even in the event of a material foreign currency rate fluctuation the Bank would face a low net income change.

On 31 December 2018, the Bank's open positions by currencies represented minimal risks, too:

31.12.2018 data in HUF M

Currency	Balance sheet net open positions	Spot positions	Net futures positions	Net open positions by currencies
USD	(9 433)	264	9 174	5
CHF	(29)	25	-	(4)
CAD	-	-	-	-
GBP	(9)	19	-	10
DKK	(1)	-	-	(1)
SEK	(1)	-	-	(1)
NOK	10	-	-	10
AUD	22	(20)	-	2
JPY	15	-	(14)	1
RON	(4)	-	-	(4)
EUR	11 913	643	(12 582)	(26)
CZK	4	-	-	4
PLN	(54)	63	-	9

3.5 Market risk in trading book

A market risk represents the risk that the fair value of a financial instrument will fluctuate in response to changes in market prices. From among market risks, the Bank exposes itself to foreign currency and interest rate risks in the trading book portfolio; however, the authorised extent of risks is restricted by stringent limits.

For the measurement of market risks the Bank employs the Value-at-Risk (VaR) method which serves to estimate the maximum expected loss for an assumed period and at an assumed confidence level. During the daily measurement of market risks, the Bank uses a 10-day, 99% VaR which indicates that the potential loss that could be sustained over a period of 10 days will not exceed the value of VaR with a 99% probability rate. An advantage of the VaR-based market risk measurement methodology is that it takes account of the volatility observed on the market as well as the diversification and correlation effects between risk types. The Bank quantifies the value of VaR with daily regularity on the basis of a variance-covariance approach, and also carries out a stressed VaR-based calculation, as part of which the covariance and correlation matrix is determined for measuring VaR on the basis of the development of prices during an earlier historical stress period.
The Bank quantifies the VaR value by risk types (foreign currency exchange rate and interest rate risks) as well as for the entire trading book portfolio. The VaR of the entire trading book portfolio is below the sum of VaR values determined by risk types due to diversification effects.
The Bank checks the reliability of the VaR models monthly, as part of which the results of the daily VaR measurements are compared with the actual changes in the value of the portfolio exposed to market

risks. Based on these control measurements, the Bank reviews its measurement methodology if necessary.
In addition to VaR-based market risk measurements, the Bank also monitors market risks in the trading book with other measurements. The Bank carries out daily sensitivity tests by risk types in respect of the trading book portfolio, and furthermore the trading book portfolio stress tested regularly to assess how the trading book portfolio would respond to market shocks.

Treasury has been authorised to hold intended overnight FX positions since March 2018, while the holding of securities positions for trading purposes has been permitted since December 2018.

The VaR relating to the trading portfolio can be summed up as follows (in HUF million):

data in HUF M

Parametric VaR (99%. 10 days) - daily average		
Risk type	**2019**	**2018**
Foreign exchange	2.56	0.43
Interest rate	0.71	1.24
Total trading book VaR	2.13	1.27
Diversification	1.14	0.40

3.6 Capital management and capital requirements

The Bank prepares its capital requirement calculations in accordance with Basel III/CRR (Regulation 575/2013/EU). The purpose of the Basel III global directives identified within the EU's regulatory framework system is to create security for financial systems, to maintain appropriate capital reserve and liquidity levels whilst ensuring equal opportunities for market players, to develop appropriate risk management capabilities adjusted to each player's activities, and to cover any losses that may emerge during their operations. In Hungary the Capital Requirements Regulation (CRR) is directly in effect.

Basel III rests on three pillars: minimum capital requirements, supervisory review and market disclosure (discipline). Basel III offers three approaches, representing different levels of approach, for the calculation of credit risk capital requirements under Pillar 1. Budapest Bank calculates its capital requirement according to the standardised approach which requires banks to use external credit ratings for determining the risk weights applied to rated counterparties, classifies other counterparties into broad categories, and applies standardised risk weights to these categories. Basel III prescribes a capital requirement for operational risks.
The Bank Group identifies an operational risk tolerance limit for the assessment of internal loss data. This determines the level of financial losses arising from operational risk events which is acceptable for the Bank Group on an annual level. The Bank operates an integrated risk management system to explore, analyse and improve the risks and controls built into its processes. At present, for the calculation of capital requirements, the Bank employs the AMA method to determine the capital requirements related to operational risks.

Pillar 2 of Basel III (supervisory review and assessment) assesses the additional capital requirement of risks not or only partly covered under Pillar 1 with a so-called advanced measurement approach, with the involvement of supervisory regulatory agencies. The Bank Group's lead regulatory agency, the National Bank of Hungary determines and reviews capital requirements for the entire group.

⟹ Consolidated Notes to the Financial Statements – Statement of Financial Position

Pillar 3 of Basel III relates to market discipline, and its purpose is to enhance the transparency of companies by obliging them to disclose specific, pre-defined details of their risks as well as of their capital and risk management procedures under Basel III.

According to the capital adequacy regulations, the consolidated capital adequacy ratio are as follows:

data in HUF M

Basel III capital adequacy	**2019**	**2018**
Equity		
Share capital	19 396	19 396
Reserves	143 096	134 777
Accumulated other comprehensive income	2 349	(121)
Intangible assets	(15 743)	(12 929)
AVA prudent valuation	(157)	(60)
Deductible deferred tax receivables	(83)	(65)
Tier 1 capital	148 858	140 998
	-	-
Tier 2 supplementary capital elements	-	-
Regulatory capital	148 858	140 998
Risk weighted assets (RWA)	880 397	817 510
Operational risk (OR)	98 158	98 707
Market risk (MR)	206	95
Credit valuation adjustment	4 668	1 149
Total risk weighted assets	983 429	917 461
Capital adequacy ratio	15.14%	15.37%

Compared to the capital adequacy ratio featured in the 2018 consolidated annual financial statement, after the signing of the consolidated annual financial statement, the final 2018 capital adequacy ratio changed slightly from 15.35% to 15.37%.
The Bank immediately recognised the effects of IFRS 9 impairment in its Tier 1 capital determined for regulatory purposes, not availing itself of the option of recognising the effects of IFRS 9 impairment in the Tier 1 capital over a period of several years.

4 FOOTNOTES TO STATEMENT OF FINANCIAL POSITION

4.1 Cash and cash equivalents

data in HUF M

	31.12.2019	31.12.2018
1-day interbank deposits	-	11 000
1-day deposits NBH	163 390	-
Interbank money transport	92	-
Bank accounts	-	-
Securities with a term of less than 3 months upon recognition	-	-
Settlements with central bank (NBH single account)	3 329	6 337
Loans from associates	-	-
Cash	19 122	16 057
Nostro	6 130	25 630
Impairment (stage1)	(4)	(1)
Total	**192 059**	**59 023**

4.2 Derivative assets

The Bank only enters into derivative OTC transactions and values them through profit/loss on a mandatory basis. The interest rate swap includes both IRS and MIRS products (also the HIRS product in 2018).

The Bank's open derivative transactions were as follows on 31 December 2019:

31.12.2019 data in HUF M

Type of derivative transaction	Face value asset side	Face value liability side	Asset FMV	Liability FMV	Net position	Derivative financial assets	Derivative financial liabilities	Remaining term (years) weighted with face value
Interest rate swap	454 034	(454 034)	456 553	(462 708)	(6 155)	2 994	(9 149)	4.1
CIRS	8 622	(9 198)	8 782	(9 228)	(446)	-	(446)	6.8
Foreign exchange forward	19 501	(19 590)	19 525	(19 600)	(75)	26	(101)	0.3
Foreign exchange swap	45 227	(45 158)	45 212	(45 156)	56	117	(61)	0.2
Total	527 384	(527 980)	530 072	(536 692)	(6 620)	3 137	(9 757)	

In 2018 the Group entered into HUF-denominated interest rate swap transactions (monetary policy interest rate swap, MIRS) with the National Bank of Hungary (NBH), as part of which it receives interest at a rate which is the equivalent of the 6-month BUBOR every six months and pays fixed interest annually to the NBH. Upon the conclusion of MIRS transactions, the Group did not pay the NBH a fee. The fixed interest payable in MIRS transactions was more favourable at the time of their conclusion than the fixed interest payable in interest rate swap transactions with similar parameters available on the market. As a result, the initial fair value of these transactions was higher than their transaction price (HUF 0). The Group accounted for this gain (HUF 2,513 million) immediately upon the initial recognition of the MIRS transactions in the net income statement in the "Net trading income/(losses)" line.

The Bank's open derivative transactions were as follows on 31 December 2018:

31.12.2018								data in HUF M
Type of derivative transaction	**Face value asset side**	**Face value liability side**	**Asset FMV**	**Liability FMV**	**Net position**	**Derivative financial assets**	**Derivative financial liabilities**	**Remaining term (years) weighted with face value**
Interest rate swap	465 546	465 546	466 255	(466 623)	(368)	2 518	(2 886)	2.6
CIRS	13 959	(14 453)	14 908	(15 281)	(373)	-	(373)	7.7
Foreign exchange forward	12 212	(12 243)	12 260	(12 248)	12	42	(30)	0.5
Foreign exchange swap	12 877	(12 934)	12 874	(12 937)	(63)	53	(116)	0.1
Total	504 594	425 916	506 297	(507 089)	(792)	2 613	(3 405)	

4.3 Securities

data in HUF M

	Rating	Valuation hierarchy	**31.12.2019**
Trading securities			
Government bonds			
Treasury bills			
Securities valued at fair value through profit or loss on a mandatory basis*			
Funds	N/A	Level1	2 449
Stock exchange shares	N/A	Level1	980
Securities valued at fair value through other comprehensive income			
Government bonds	Baa3	Level1	90 423
Mortgage debentures	Baa2	Level2	36 534
Treasury bills			
Corporate bonds	Ba3 / Ba2	Level2	3 762
Compensation warrants	Baa3	Level2	36
Securities valued at amortised cost value			
Government bonds	Baa3	Level1	170 103
Mortgage debentures			
Treasury bills			
Credit institution bonds	Baa3	Level2	33 112
			337 399

"Funds" solely represent securities purchased in open-end investment funds. The Group purchased the investment units held in the year-end portfolio in money market funds on the trading day preceding the reporting date for liquidity management purposes.

The interest income of FVTPL* securities are recognised in the line "Net income /(loss) from financial instruments valued at FVTPL".

In 2018 there were no repurchase (repo) transactions at all. In 2019, the Bank paid HUF 2 million in total in interest on repo transactions.

data in HUF M

	Rating	Valuation hierarchy	31.12.2018
Trading securities			**151**
Government bonds	Baa3	Level1	151
Treasury bills			
Securities valued at fair value through profit or loss on a mandatory basis*			**5 295**
Funds	N/A	Level1	3 872
Stock exchange shares	N/A	Level1	1 423
Securities valued at fair value through other comprehensive income*			**43 250**
Government bonds	Baa3	Level1	26 524
Mortgage debentures	Ba3	Level2	16 680
Treasury bills			
Compensation warrants	Baa3	Level2	46
Securities valued at amortised cost value			**258 787**
Government bonds	Baa3	Level1	225 182
Mortgage debentures			
Treasury bills			
Credit institution bonds	Baa3	Level2	33 605
			307 483

*The Group regards securities with a term of less than 3 months at the time of their purchase as cash and cash equivalents, and therefore recognises them in the cash and cash equivalents balance sheet line.

4.4 Loans and advances to banks

data in HUF M

Breakdown of loans and advances to banks	31.12.2019	31.12.2018
Interbank placements	300	2 975
Margin coverage	8 600	4 213
Other	8	7
NBH separated deposits	6	6
Loans and advances to banks	**8 914**	**7 201**

4.5 Loans and advances to customers

31.12.2019 data in HUF M

Description	Gross portfolio	Impairment Allowance	Net portfolio
Unsecured retail loans	99 202	8 949	90 253
Secured retail loans	312 864	22 929	289 935
Corporate loans and leases	541 063	16 707	524 356
Other receivables	5 027	-	5 027
Receivables valued at amortised cost value	**958 156**	**48 585**	**909 571**
Loans valued at fair value through profit or loss on a mandatory basis	24 340	-	24 340
Total loans and advances to customers	**982 496**	**48 585**	**933 911**

31.12.2018 data in HUF M

Description	Gross portfolio	Impairment Allowance	Net portfolio
Unsecured retail loans	87 920	11 313	76 607
Secured retail loans	276 265	36 438	239 827
Corporate loans and leases	514 005	13 866	500 139
Other receivables	5 984	-	5 984
Receivables valued at amortised cost value	**884 174**	**61 617**	**822 557**
Loans valued at fair value through profit or loss on a mandatory basis	3 851	-	3 851
Total loans and advances to customers	**888 025**	**61 617**	**826 408**

The Group recognises the loans denominated in HUF and EUR and provided for small and medium-sized enterprises (SMEs) as part of the Growth Credit Programme (GCP) among loans and advances to customers. The interest on loans provided for SMEs as part of GCP is fixed, maximum 2.5%. At the disbursement of the loans, this interest rate was more favourable than market interest rates, and therefore a difference arose between the face and the fair value of the loans upon recognition. The Group has immediately accounted for this difference in the net income (2.3.1.1 a) since 2019. See further information on loans and impairment in Chapter 3.1 Credit risk.

Loans valued at fair value

Loans valued at fair value were only recognised according to the IFRS 9 rules in 2018; statements under AA from periods before 2018 did not include credit portfolios valued at fair value. Fair value hierarchy of the loans is Level 3. The interest income of these loans and any other changes in fair value are accounted for in the line “Net income /(loss) from financial instruments valued at FVTPL” (see paragraph 5.5). For further information on the valuation of loans at fair value see paragraphs 2.3.1.3 “S”, 5.5 and 6.7.

Loans valued at fair value through profit or loss changed as follows during 2019:

data in HUF M

Description	**Level 3**
Gross portfolio Opening	3 851
Of which fair value difference	*(217)*
Change in fair value difference of gross portfolio	7
Gross portfolio disbursement	21 234
Gross portfolio interest income	412
Gross portfolio repayment	(1 164)
Gross portfolio derecognition profit/loss	-
Reclassification to gross portfolio	-
Reclassification from gross portfolio	-
Gross portfolio Closing	**24 340**
Of which fair value difference	*(308)*

Macro-hedged loans

The Bank reduces the interest risk of fixed-interest loans with interest swaps. At the end of 2019, a fixed-interest credit portfolio and an interest swap portfolio worth HUF 128.1 billion were matched in hedging relationships. Fair value differences of the hedging interest swaps are stated in the balance sheet line “Derivatives” (see paragraph 4.2).

data in HUF M

	Face value of interest rate swaps in hedge relationships	**Fair value difference of IRSs in hedge relationships**
Assets	23 383	275
Liabilities	104 690	(3 725)
	128 073	(3 450)

In 2019 the Bank accounted for a net loss of HUF 3,299 million on interest swaps in hedging relationships. In 2019 during the terms of hedging relationships, the Bank accounted for a profit of HUF 2,516 million on changes in interest risks related to the hedged fixed-interest-bearing loans which are stated in the balance sheet line “Loans and advances to customers”. An unamortised sum of HUF 2,850 million arising from closed hedging relationships is recorded in the balance sheet line “Other assets” (paragraph 4.9).

data in HUF M

	Fix-interest loans	Interest rate swaps	Net profit/loss
Positive fair value change	5 796	3 033	
Negative fair value change	(3 280)	(6 332)	
	2 516	**(3 299)**	**(783)**

See net profit/loss effect in paragraph 5.5.

Details of lease receivables

data in HUF M

	31.12.2019	31.12.2018
Gross lease receivables		
Within 1 year	79 430	62 146
Within 1-5 years	144 316	120 171
Beyond 5 years	8 930	8 437
Total	**232 676**	**190 754**
Present value of minimum lease payment		
Within 1 year	71 418	55 635
Within 1-5 years	133 371	111 249
Beyond 5 years	8 349	7 900
Total	**213 138**	**174 784**
Unearned revenues	19 538	15 970
Non-guaranteed residual value	17 194	17 063

The Group as lessor only has finance leases, though from a legal point of view it is engaged in both operating and finance lease activities (open-end and closed-end finance leases).

- Closed-end finance lease: During the term, ownership of the asset remains with the Lessor. At the end of the term, upon the payment of the last lease fee, the Lessee automatically acquires title to the leased asset.
- Open-end finance lease: During the term, ownership of the asset remains with the Lessor; however, at the end of the term the Lessee is free to decide whether to exercise its pre-emptive right and to acquire title to the leased asset through the payment of the residual value, or to exercise the right of appointing a buyer and the leased asset is sold at the residual value directly to a third party, or to return the leased asset to the Lessor.

Lease transactions are denominated in HUF and EUR. The term of the portfolio ranges between 1 and 11 years; average term: 5 years.

The Company's lease agreements do not include lease (rental) fees that are subject to performance indicators on the lessee's part.

4.6 Investments in subsidiaries, joint ventures and associates

At present, the Bank has investments in the following three subsidiaries which constitute the Bank Group together with the Bank. See detailed introduction of subsidiaries in Chapter 1.2.

data in HUF M

Name	Cost value	Vote %	Equity	Share capital	Current year comprehensive income	Total assets
Budapest Lízing Zrt	6 380	100%	7 406	62	1 089	123 660
Budapest Alapkezelő Zrt	10	100%	2 614	500	2 036	2 971
Budapest Eszközfinanszírozó Zrt	2 006	100%	1 711	15	(434)	4 246

4.7 Property, plant, equipment and intangible assets

The gross value and amortisation of the Bank's tangible assets were as follows during 2018 and 2019:

data in HUF M

Changes during 2019	Properties	Right-of-use assets (properties)	IT equipment	Other	Total
Cost value					
Closing balance on 31.12.2018	**10 409**	0	**6 533**	**7 746**	**24 688**
Effect of IFRS 16	-	13 348	-	-	13 348
Opening balance on 1 January 2019	**10 409**	**13 348**	**6 533**	**7 746**	**38 036**
Purchase and self-construction	562	2 369	1 583	1 078	5 592
Reclassification	-	-	-	-	-
Sales, derecognitions	(218)	(12)	(713)	(1 241)	(2 184)
Balance on 31.12.2019	**10 753**	**15 705**	**7 403**	**7 583**	**41 444**
Opening balance on 1 January 2019	**5 115**	**-**	**5 157**	**4 806**	**15 078**
Depreciation	592	1 975	800	795	4 162
Sales, derecognitions	(204)	(12)	(704)	(1 072)	(1 992)
Reclassification	-	-	-	-	-
Balance on 31.12.2019	**5 503**	**1 963**	**5 253**	**4 529**	**17 248**
Net opening balance on 1 January 2019	**5 294**	**13 348**	**1 376**	**2 940**	**22 958**
Net balance on 31.12.2019	**5 250**	**13 742**	**2 150**	**3 054**	**24 196**
Changes during 2018					
Cost value					
Opening balance on 1 January	**9 820**	**0**	**5 775**	**7 329**	**22 924**
Purchase and self-construction	591	-	912	1 248	2 751
Reclassification	-	-	(1)	1	-
Sales, derecognitions	(2)	-	(153)	(832)	(987)
Balance at the end of reporting period	**10 409**	**0**	**6 533**	**7 746**	**24 688**
Depreciation					
Opening balance on 1 January	**4 586**	**0**	**4 529**	**4 719**	**13 834**
Depreciation	530	-	776	749	2 055
Sales, derecognitions	(1)	-	(147)	(663)	(811)
Reclassification	-	-	(1)	1	-
Balance at the end of reporting period	**5 115**	**0**	**5 157**	**4 806**	**15 078**
Book value					
Net opening balance on 1 January	**5 234**	**0**	**1 246**	**2 610**	**9 090**
Net balance at the end of period	**5 294**	**0**	**1 376**	**2 940**	**9 610**

The Bank has no self-constructed assets or properties; no expenses incurred for this purpose. At the end of 2019, the Bank had contractual obligations worth of HUF 176 million for the purchase of property, plant and equipment.

Intangible assets include software and rights representing assets.

31.12.2019 data in HUF M

	Software	Rights representing assets	Total
Gross	39 115	160	39 275
Accumulated amortisation	(23 376)	(156)	(23 532)
	15 739	**4**	**15 743**

31.12.2018 data in HUF M

	Software	Rights representing assets	Total
Gross	35 161	164	35 325
Accumulated amortisation	(22 237)	(159)	(22 396)
	12 924	**5**	**12 929**

In 2018 and 2019 the Bank did not account for expenditures for research and development purposes. At the end of 2019, the Bank had contractual obligations worth HUF 2,666 million for the procurement of software. There is no collateral or any other restriction on the Bank's properties, plants, equipment and intangible assets restricting its ownership rights.

4.8 Tax receivables and tax liabilities

The Bank Group's individual subsidiaries closed their financial years with individual tax receivable or tax liability positions which were not netted in the consolidated statement of financial position. The net tax positions changed as shown in the movements table below, also with regard to the deferred tax effect of the IFRS 9 transition on 1 January 2018.

data in HUF M

	31.12.2019	31.12.2018
Development of deferred tax portfolio		
Deferred tax receivables(+) / liabilities(-) portfolio		
Opening	232	296
Current-year change	14	(64)
Closing	246	232
Deferred tax from securities valued at fair value through OCI		
Opening	13	(115)
Current-year change	(244)	186
Reclassification to current-year profit/loss	-	(58)
Closing	(231)	13
Total deferred tax	**15**	**245**
Deferred tax receivables(+) / liabilities(-)	15	245
Actual income tax receivables(+) / liabilities(-)	(80)	865
Balance sheet net tax receivables	**(65)**	**1 110**
Balance sheet tax receivables(+)	407	1 111
Balance sheet tax liabilities(-)	(472)	(1)
Balance sheet net tax receivables	**(65)**	**1 110**

data in HUF M

Deferred tax breakdown by temporary differences	31.12.2019	31.12.2018
Opening		
On provisions	77	107
On tangible assets, intangible assets	88	80
On impairment	2	4
On accrued loss	65	105
	232	**296**
Current-year change		
On provisions	5	(30)
On tangible assets, intangible assets	(9)	8
On impairment	-	(2)
On accrued loss	18	(40)
	14	**(64)**
Closing		
On provisions	82	77
On tangible assets, intangible assets	79	88
On impairment	2	2
On accrued loss	83	65
	246	**232**

4.9 Other assets

data in HUF M

	31.12.2019	31.12.2018
Tax and tax-type items	1 493	1 476
Deferral of revenues	1 320	1 193
Deferral of costs and expenditures	909	764
Euronet settlement account	-	1 973
Card settlement accounts	628	745
Inventories*	3 493	67
Impairment of inventories	(118)	(33)
Clearing accounts	268	189
Settlement account related to retail housing loans	1 564	490
Finance lease settlement accounts	1 610	1 401
Other assets	1 973	1 816
Other impairment	(392)	(295)
Change in fair value of secured items during portfolio hedging	2 850	335
Investments in other enterprises	197	236
	15 795	**10 357**

*Assets repossessed from lease contracts, primarily buses and agricultural machinery, their sale is in progress.

Repossessed assets – primarily in connection with lease activities – are carried in the inventories:

data in HUF M

	31.12.2019	31.12.2018
Gross value of repossessed assets*	3 429	49
Impairment of repossessed assets	(118)	(33)
Gross value of other inventories	64	18
Impairment of other inventories	-	-
	3 375	**34**

Impairment accounted for in respect of assets repossessed in 2019	(98)
Impairment accounted for in respect of assets repossessed in 2018	(10)

*Assets repossessed from lease contracts, primarily buses and agricultural machinery, their sale is in progress.

Investments in other enterprises on 31 December 2019:

data in HUF M

Name of enterprise	Head office	Cost value	Voting %
Garantiqa Hitelgarancia Zrt	1082 Budapest, Kisfaludy utca 32.	190	2.42%
Swift	Avenue Adele 1 B 1310 La Hulpe Belgium	7	0.02%

4.10 Deposits from banks

data in HUF M

	31.12.2019	31.12.2018
Refinancing funding - NBH	83 189	61 075
Refinancing funding - other banks	52 511	47 896
Refinancing funding - mortgage banks	51 255	34 187
Interbank funding	10 161	3 652
Deposits from MFB	15 019	16 109
Deposits from other banks	417	469
	212 552	**163 388**

Pledged assets supplied by the Bank as collateral amounted to HUF 97,884 million of securities and HUF 43,111 million of receivables on 31 December 2019.

The Company recognises the refinancing funding received from the NBH with 0% interest as part of the Growth Credit Programme (GCP) in deposits from banks.

4.11 Deposits from customers

data in HUF M

	31.12.2019	31.12.2018
Retail deposits	307 353	276 401
Corporate deposits	729 556	546 496
Deposits from investment funds	38 995	39 163
Investment services settlement accounts	21 149	20 095
Suppliers	6 350	6 402
Financial lease liability*	14 103	-
Other customers	3 643	3 516
	1 121 149	**892 073**

*Effects of IFRS 16 conversion (see Section 2.1)

4.12 Provisions

The following provisions were accounted for the off-balance-sheet contingent liabilities:

31.12.2019 data in HUF M

Contingent liabilities	Gross	Provisions
Undrawn lines of credit and guarantees	337 376	1 056
Other contingent liabilities (including lawsuits)	1 968	1 143
Total contingent liabilities	**339 344**	**2 199**

31.12.2018 data in HUF M

Contingent liabilities	Gross	Provisions
Undrawn lines of credit and guarantees	343 770	953
Other contingent liabilities (including lawsuits)	1 393	1 292
Total contingent liabilities	**345 163**	**2 245**

Amounts stated as “gross” represent the maximum available credit line or the maximum amount payable by the Group in connection with financial guarantee contracts. In case of other contingent liabilities, the “gross” amount is the estimated maximum amount payable by the Group.

The Bank rates and creates provisions for its few litigations of significant amounts individually. The Bank makes provisions in the amount of the expected loss for litigations where the likelihood of a negative outcome is more than 50%. Litigations take typically several years to conclude.

4.13 Other liabilities

data in HUF M

Breakdown of other liabilities	31.12.2019	31.12.2018
Monthly accruals of costs	2 564	2 095
Credit card overpayments	2 824	3 096
Clearing accounts	3 254	5 742
Tax and tax-type items	2 200	2 073
Card settlement accounts	1 418	901
Other	8 331	7 664
	20 591	**21 571**

4.14 Share capital

There was no change in the share capital in 2019.

Description	Face value (HUF)	Number of shares	Value (HUF M)
Opening balance 01.01.2019	1 000	19 395 945	19 396
Current-year change	-	-	-
Closing balance 31.12.2019	1 000	19 395 945	19 396

The Bank's issued capital consists of ordinary registered shares each with face value of HUF 1,000, 100% of which are held by Corvinus Nemzetközi Befektetési Zrt (see Chapter 1.1).

Description	Share type	Face value (HUF)	Number of shares	Value (HUF M)
Ordinary shares	registered	1 000	19 395 945	19 396

4.15 Reserves

In 2019 accumulated other comprehensive income was generated in relation to securities:

data in HUF M

Opening valuation difference of securities valued at fair value through other comprehensive income	(120)
Effect of interim purchases and exchange rate changes	2 874
Derecognition due to maturity	9
Net amount transferred to profit/loss due to sale	(170)
Effect of deferred tax	(244)
Accumulated other comprehensive income closing	**2 349**

5 FOOTNOTES TO INCOME STATEMENT

5.1 Net interest income

data in HUF M

Interest income	**2019**	**2018**
Cash and cash equivalents	117	97
Securities valued at fair value through comprehensive income	925	773
Securities valued at amortised cost value	4 231	2 984
Loans and advances to banks valued at amortised cost value	335	1 012
Loans and advances to customers valued at amortised cost value	38 083	31 756
- of which lease interest not accounted for with effective interest rate method	*9 367*	*6 271*
Default interest income	1 105	1 246
- of which lease interest not accounted for with effective interest rate method	*27*	*9*
Interest income	**44 796**	**37 868**

Interest expense	**2019**	**2018**
Deposits from banks valued at amortised cost value	(989)	(448)
Deposits from customers valued at amortised cost value	(853)	(457)
Interest expense	**(1 842)**	**(905)**
Net interest income	**42 954**	**36 963**

The above interest income and expenses were accounted for with the effective interest rate method, see paragraph 2.2 D. In case of FVTPL financial assets where interest is calculated differently, interest income and expenses are not stated in the interest income and expense line, but in the line ”Net income /(loss) from financial instruments valued at FVTPL”.

5.2 Net fee and commission income

data in HUF M

Fee and commission income	2019	2018
Fee and commission income related to funds	4 330	4 552
Insurance commission income*	1 669	-
Fee and commission income from current account and savings products	29 548	26 148
Fee and commission income from credit products	4 972	4 691
Customer conversion income (trade income)	5 130	4 552
Fee and commission income	**45 649**	**39 943**

Fee and commission expense	2019	2018
Trading and other commissions	(491)	(392)
Bank card and credit card commissions	(4 730)	(4 495)
Commissions related to account keeping and loans	(1 467)	(1 170)
Fee and commission expense	**(6 688)**	**(6 057)**
Net fee and commission income	**38 961**	**33 886**

*Stated in "Other operating income" line in 2018 Statement of Comprehensive Income.

5.3 Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)

data in HUF M

Description	2019	2018
Credit institutions FVTOCI - gains/losses	-	23
Government bonds FVTOCI - gains/losses upon derecognition	-	(670)
Government bonds AC - gains/losses upon derecognition	2 582	(183)
Other shares - gains/losses upon derecognition	(1)	7
Corporate bonds FVTOCI - gains/losses	170	-
Sale of own receivables	1 551	2 700
Net gains/(losses) arising from derecognition of financial assets (valued at not FVTPL)	4 302	1 877

See definitions and contents of the abbreviations in paragraphs 2.3.1-3. Upon derecognition (typically in the event of sale), in every instance the Bank transfers the fair value differences accounted for in other comprehensive income to the current-year profit/loss in this line.

Sale of receivable represents the net profit/loss of default loans sold on the collections market.

5.4 Net trading income/(losses)

data in HUF M

Description	2019	2018
Interest rate swap	2 922	1 312
CIRS	124	(781)
Foreign exchange swap	(890)	(625)
Foreign exchange forward	(302)	144
Government securities	(99)	-
Total	**1 755**	**50**

The Bank enters into OTC derivative transactions valued through profit or loss on a mandatory basis. As part of the Market Credit Programme launched by the NBH in 2016, the Bank concluded interest rate swap transactions (HIRS) amounting to HUF 95,990 million, with maturity in February 2019. The Bank accounted for the initial market value of HIRSs pro-rata up to the end of the term as trading income (HUF 973 million in 2018). The balance of the initial deferred profit amounted to HUF 157 million on 31 December 2018.

5.5 Net income /(loss) from financial instruments valued at FVTPL

data in HUF M

Description	2019	2018
Interest of non-trading financial assets valued at fair value through profit or loss on a mandatory basis	412	191
Fair value of non-trading financial assets valued at fair value through profit or loss on a mandatory basis	(453)	(301)
Net profit/loss of hedging transactions	(783)	(244)
Total	(824)	(354)

The fair value of financial assets arises from the fair value adjustments of HUF 7 million related to loans valued at fair value (see paragraph 4.5) and of HUF 446 million accounted for shares and funds quoted at stock exchange (see paragraph 4.3).

See further information on credit-related hedging transactions in Chapters 4.5 and 2.4.3.

5.6 Other operating income and expenses

data in HUF M

Breakdown of other operating income	2019	2018
Insurance*	-	1 533
Other	917	490
Adjustments from previous year	1 909	2 695
Initial fair value on refinancing liabilities**	685	-
Intermediary activities	778	483
Recharges	184	296
Other operating income	**4 473**	**5 497**

Breakdown of other operating expenses	2019	2018
Bank tax	(1 854)	(2 071)
Other	(1 026)	(987)
Damages, fines	(56)	(386)
Mandatory membership fees	(1 812)	(2 002)
Initial fair value on loans**	(685)	-
Non-deductible VAT	(1 617)	(1 509)
Transaction duty	(13 285)	(12 076)
Other operating expenses	**(20 335)**	**(19 031)**
Net other profit/loss	**(15 862)**	**(13 534)**

*Stated in "fee and commission income" line in 2019 Statement of Comprehensive Income.
**In conjunction with the NBH Growth Credit Programme Fixed, from 2019 the Bank recognises initial fair value in respect of loans and leases provided as part of the programme, and disbursed refinancing liabilities.

5.7 Administrative expenses

data in HUF M

Personnel expenses	**2019**	**2018**
Salaries	(21 771)	(20 070)
Salary taxes / contribution	(5 058)	(4 941)
Other personnel expense	(1 594)	(1 331)
Personnel expenses	**(28 423)**	**(26 342)**

Other administrative expenses	**2019**	**2018**
Facility management expenses	(2 647)	(4 230)
IT expenses	(3 670)	(3 653)
Marketing expenses	(2 307)	(2 433)
Communication expenses	(1 128)	(1 123)
Professional fees	(1 569)	(1 057)
Expenses of services used	(1 128)	(957)
Other administrative expenses	(2 123)	(2 241)
Other administrative expenses	**(14 572)**	**(15 694)**
Administrative expenses	**(42 995)**	**(42 036)**
Staff (number of persons)	3 006	2 952

5.8 Depreciation and amortisation

data in HUF M

Breakdown of depreciation of properties, plant and equipment	2019	2018
Properties	(592)	(530)
IT equipment	(800)	(776)
Right-of-use asset*	(1 975)	-
Other	(795)	(749)
Depreciation of properties, plant and equipment	**(4 162)**	**(2 055)**

Breakdown of depreciation of intangible assets	2019	2018
Intangible assets	(3 877)	(3 800)
Depreciation of intangible assets	**(3 877)**	**(3 800)**
Depreciation and amortisation	**(8 039)**	**(5 855)**

*From 1 January 2019, based on the IFRS 16 standard, the Bank capitalises long-term lease agreements as right-of-use assets and recognises depreciation in respect thereof.

5.9 Net (impairment loss)/ reversal of impairment loss on financial assets & provision

data in HUF M

Description	2019	2018
Impairment (loss) / release related to lending	2 041	(1 187)
Net effect of cancellations and write-offs of loans	(498)	(943)
Provisions (made) / released	(51)	(370)
Impairment for other financial instruments	133	30
Total	**1 625**	**(2 470)**

5.10 Income tax expense

data in HUF M

	2019	2018
Actual tax expenditures		
corporate income tax	215	345
local business tax	2 083	1 632
innovation contribution	313	236
	2 611	**2 213**
Adjustments accounted for actual tax expenditures of earlier periods		
corporate income tax	63	147
local business tax	35	(4)
innovation contribution	-	-
	98	**143**
Deferred tax expenditures(+) / revenues(-)		
current-year	33	103
adjustments of earlier periods	(47)	-
	(14)	**103**
Deferred tax write-off(+) / reversal(-)		
write-off	-	-
reversal	-	-
	-	**-**
Deferred tax on accrued losses not recognised earlier	**-**	**(40)**
Income tax expense	**2 695**	**2 419**

Analysis of effective tax rate

data in HUF M

	2019	2018
Profit before income tax (a)	14 266	14 958
Tax expected on the basis of profit before income tax [a*9%]	1 284	1 346
local business tax effect (current-year and previous year's)	2 117	1 628
innovation contribution effect (current-year and previous year's)	313	235
previous year's corporate tax effect	64	147
previous year's deferred tax effect	(47)	-
effect of permanent differences	(1 111)	(504)
effect of deferred tax write-off, reversal	-	-
effect of accrued loss not recognised as deferred tax	-	(40)
tax relief effect	(566)	(496)
other effects (due to consolidation)	641	103
Income tax expense	**2 695**	**2 419**
Income tax expense recognised in profit and loss account (b)	**2 695**	**2 419**
Effective tax rate (on total income tax) [b/a]	**18.89%**	**16.17%**

6 OTHER INFORMATION

6.1 Financial indicators

		Year 2019	Year 2018
Profitability ratios:			
Profit margin	Profit for the year / Total revenues[1]	11 571 / 94 918 = 12.19%	12 539 / 83 308 = 15.05%
ROA	Profit for the year / Closing assets	11 571 / 1 531 561 = 0.76%	12 539 / 1 236 735 = 1.01%
ROE (1)	Profit for the year / Equity	11 571 / 164 841 = 7.02%	12 539 / 154 052 = 8.14%
ROE (2)	Profit for the year / Share capital	11 571 / 19 396 = 59.66%	12 539 / 19 396 = 64.65%
Capitalisation ratio:			
Capital leverage ratio	Total assets / Equity	1 531 561 / 164 841 = 9.29	1 236 735 / 154 052 = 8.03
Coverage ratio:			
Credit in % of deposits	Total loans and leases / Total deposits	942 825 / 1 333 701 = 70.69%	833 609 / 1 055 461 = 78.98%
Efficiency ratios:			
Income per capita	Profit for the year / Average staff	11 571 / 3 006 = 3.85	12 539 / 2 952 = 4.25
Costs/net revenues ratio	Costs[2] / Net revenues[3]	42 995 / 81 915 = 52.49%	42 036 / 70 849 = 59.33%

The values used for the calculation of indicators are stated in HUF million.

Comments:

- Total revenue: interest income, dividend income, fee and commission income, other operating income.
- Costs: personnel expenses, other administrative expenses.
- Net revenues: net interest income, net fee and commission income.

⟹ Consolidated Notes to the Financial Statements – Other Information

6.2 Payments to members of Board of Directors and Supervisory Board for 2019 business year

Description	Persons receiving remuneration (persons)	Amount of remuneration (HUF M)
Board of Directors	6	21
Supervisory Board	6	14
Total	**12**	**35**

6.3 Loans provided for members of Board of Directors, Management and Supervisory Board

data in HUF M

Description	Disbursement	Amortisation	Outstanding debt on 31 December 2019	Material terms and conditions
1. Interest-free employer loans				long-term loan,
- Board of Directors	-	-	-	mortgage on property
- Supervisory Board	-	-	-	property collateral
1. Total:	**-**	**-**	**-**	
2. Preferential housing loans				long-term loan,
- Board of Directors	-	-	-	mortgage on property
- Supervisory Board	7.00	4.10	2.90	property collateral
2. Total:	**7**	**4**	**3**	
3. Mortgage loans				long-term loan,
- Board of Directors	25.00	25.00	-	mortgage on property
- Supervisory Board	-	-	-	property collateral
3. Total:	**25**	**25**	**-**	
4. Personal loans				
- Board of Directors	-	-	-	long-term loan,
- Supervisory Board	-	-	-	no collateral
4. Total:	**-**	**-**	**-**	
Grand total:	**32**	**29**	**3**	

Members of the Board of Directors and the Supervisory Board have total overdraft facilities worth of HUF 0 and credit card lines worth of HUF 1,000,000 to which the Bank’s standard contractual terms and conditions apply.

6.4 Severance pay of executives in key positions

The following benefits were paid to executives in key positions following the termination of their employment:

data in HUF M

	2019	2018
Severance pay	96	103

6.5 Terms and conditions of loans provided for subsidiaries

Company	Currency	Term	Interest rate 2019
Budapest Lízing Zrt	HUF-EUR-USD	1-10 years	0.01%-2.44%
Budapest Eszközfinanszírozási Zrt	HUF-EUR-USD	2-5 years	0.11%-2.37%

Company	Currency	Term	Interest rate 2018
Budapest Lízing Zrt	HUF-EUR-USD	2-3 years	0.37% - 2.67%
Budapest Eszközfinanszírozási Zrt	HUF-EUR-USD	2-3 years	0.30% - 2.60%

6.6 Related parties

data in HUF M

Related party	Type of transaction	Balance 31.12.2019	Balance 31.12.2018
CORVINUS ZRT	Received deposit	(2 350)	-
EXIMBANK RT	Refinancing liabilities	(51 289)	(46 103)
EXIMBANK RT	Received credit lines (MK)	4 925	3 384
EXIMBANK RT	Received guarantee (MK)	1 555	228
MFB ZRT	Purchased securities	32 975	33 513
MFB ZRT	Market value of foreign exchange swap transactions	21	-
MFB ZRT	Interbank loans received	(16 241)	(17 902)
MFB ZRT	Received credit lines (MK)	625	589
MFB ZRT	Received guarantee (MK)	32 039	38
VOLÁN TÁRSASÁGOK	Lease provided	24 391	27 960

The Bank as a state-owned company conducted the above significant transactions with related parties.

6.7 Fair value hierarchy of financial instruments not valued at fair value

In the table below the fair value of financial assets is included, in case of which the Management concluded that the book value is a good approximation of the fair value.

Financial instruments	Reasoning
Cash and cash equivalents	Quick turnover, low risk of change in fair value
Loans and advances to banks	Short term, variable interest
Deposits from customers	Mainly short term, includes settlements with suppliers
Other financial assets	Short term
Other financial liabilities	Short term

data in HUF M

Description	31.12.2019			31.12.2018		
	Book value	Fair value	Level	Book value	Fair value	Level
Securities, of which:	203 215	209 129		258 787	262 285	
Securities valued at L1	*170 103*	*175 079*	L1	*225 182*	*227 970*	L1
Securities valued at L2	*33 112*	*34 050*	L2	*33 605*	*34 315*	L2
Loans and advances to customers	933 911	940 434	L3	826 408	826 941	L3
Deposits from banks	212 552	210 144	L3	163 388	157 927	L3

In case of securities, values are based on fair market prices for transactions with an active market.

The Bank uses the technique of discounted cash flow calculation for determining the fair value of loans and advances to customers. Exceptions to this rule are sight receivables where the fair value equals to the book value, as well as non-performing transactions where the fair value is the net book value.

6.8 Dividends

At present, the expected rate of dividends payable to the owner Corvinus Nemzetközi Befektetési Zrt is not known. The Bank will pay the dividends due in relation to the Bank's financial performance in 2019 based on the decision of the Minister without Portfolio for the Management of National Assets who exercises the owner's rights. Based on the performance in 2019 Budapest Lízing Zrt decided on the payment of dividends worth HUF 1.1 billion, while Budapest Alapkezelő Zrt on the payment of dividends worth HUF 2 billion to the owner Budapest Bank.

6.9 Subsequent events

Effect of the coronavirus epidemic as a post-reporting date event on the Bank

With regard to the coronavirus situation, the Hungarian State issued a decree regulating issues related to lending – Government Decree No. 47/2020. (III. 18.) – effective as of 18 March 2020. Pursuant to the Government Decree, debtors are given respite (a payment moratorium) during the state of danger in respect of their principal, interest and fee payment obligations arising from credit, loan and finance lease products provided by the Bank on a business basis.
The payment moratorium lasts until 31 December 2020. The deadlines for the fulfilment of contractual obligations and the terms of the underlying commitments are extended by the duration of the payment moratorium. Contracts expiring during the effect of the state of danger are extended to 31 December 2020. The payment moratorium does not affect debtors' right to continue payments according to the original terms of their contracts.

The Bank's management assessed the credit, liquidity, capital, operating and other business risks arising from the coronavirus crisis and the Government Decree in 2020. The management came to the following conclusions and adopted the following measures up to the signing of this report:

Lending

The Bank's risk management unit assessed the economic impacts of the virus on different items in its portfolio, the percentage of these items in the Bank's total asset portfolio, what impairment coverage levels they have at this point in time, what impacts the credit debt repayment moratorium would have on the Bank, and what measures the Bank is planning to adopt to counter such impacts.
The Bank assessed the percentages represented by the following sectors and their respective rates of collateral and impairment coverage:

- services
- automotive and parts industry
- vehicle industry
- catering
- tourism
- light industry
- communication
- entertainment industry

In Budapest Bank's case, the automotive and related industries represent the highest percentage in the portfolio identified as most at risk.
At present, the collateral, impairment and provision coverage ratios of the exposures included in the critical portfolio are seen to be adequate. In these industries, the portfolio managed by the collections unit is not significant at this time.
For the time being, the Bank is not planning to recognise additional impairment during the moratorium either in the retail or in the corporate portfolio. In this regard, the Bank asked for the NBH's position; if necessary, the impairment models will be reviewed.
The Bank has started a development project in its basic systems to manage prolongations and any other possible solutions at system level.
As the Government Decree allows debtors to continue payments according to the original terms of their contracts, the Bank will do everything it can to identify customers who are able to pay their amortisation instalments also at this time and to convince them to continue their ongoing payments.

The Bank is waiting for further detailed regulations and the clarification of the provisions of the Government Decree.

Liquidity

The Bank analysed its liquidity situation for 2020 based on the following assumptions.
Assumptions with a negative impact on liquidity:

- the end of February 2020 closing credit portfolio will not decrease fundamentally due to the suspension of amortisation payments
- the drawdown of contracted credit lines will increase significantly in case of retail, micro- and corporate customers. Drawdowns will take place evenly during the months between March and June
- a fall in cash flow related to interest and fee income due to the moratorium.

At the end of February 2020, the Bank had significant excess liquidity considering the normal liquidity plan and relevant stress factors. With this excess, its LCR ratio stood at 167% (the statutory requirement is 100%). Assumptions with a negative impact on liquidity reduce this excess month by month. By the end of 2020, the excess liquidity will decrease significantly; however, even according to the worst-case scenario, the LCR ratio will remain at the level of the statutory requirement.
The Bank is planning to take the following actions to guarantee the liquidity level and to increase excess liquidity:

- raising extra mortgage refinancing funding
- proactively contacting customers with unchanged financial circumstances and encouraging them to continue payments on a voluntary basis

Capital position

The Bank analysed its 2020 capital position relying on the following assumptions:
Further assumptions with a negative impact on capital adequacy, in addition to the assumptions relied on for the liquidity analysis:

- the interest and fees not paid due to the moratorium will increase the credit portfolio and in consequence the RWA
- lower fee income due to losses in sales

Other assumptions:

- the statutory principal and interest moratorium does not represent restructuring, and so the existing ratings are not automatically downgraded; therefore, at present, the Bank is not planning to recognise further impairments in excess of the relevant plan. However, if necessary, the impairment models will be revised

According to the 2020 capital calculation adjusted by the above assumptions, the Bank's capital adequacy ratio will remain above the current regulatory level.
At the same time, despite the moratorium, the portfolio of repayments could enable the placement of new loans.

Operations

In accordance with the NBH's requirements, the Bank has tested scenarios for crisis situations, with special regard to the BIA critical business operations. In response to the emergence of the coronavirus crisis in Hungary, the Bank's management ordered employees to work from home in relation to all BIA

critical operations and to work from home as much as possible in relation to all other operations. The Bank has the necessary remote access technology and there was a successful changeover to working from home; the Bank's operations are free from disruptions.

Business impacts

The Bank has suspended the collection of the fees falling due in case of personal loans, sales finance, mortgages and automobile finance, and is modifying the schedules of amortisation payments accordingly. The Bank is currently developing the processes which enable customers to notify the Bank, in accordance with the Government Decree, if they do not wish to avail themselves of the moratorium. Customer communication documents are being prepared which will inform customers about the details of the moratorium, summarising what the moratorium entails as regards the remaining terms of their loans in respect of term, principal debt and excess interest burdens.

In respect of consumer loans, the Bank must comply with the latest prime rate + 5% APR laid down in the Government Decree. Also with regard to more limited risk costs, the Bank's management is developing new products and is identifying the relevant customer segment to create a placement selection which is appropriate both from risk and business points of view, also with regard to the above framework system.

Negative impacts of the coronavirus epidemic could also manifest in a fall in the value of customer portfolios managed by Budapest Alapkezelő. Parallel with the spread of the virus, in recent periods there have been significant fluctuations in multiple segments of the capital market which have negatively affected the value of the portfolios managed by Alapkezelő in consequence of a fall in the prices of the shares, corporate bonds, government securities and other money and capital market instruments included in these customer portfolios. In the portfolios Alapkezelő has typically diversified exposures from an industry point of view, and so the impacts on each sector typically only affect the individual portfolios in proportion to the weight which the given sector represents within the economy and capital market.

Other events

In order to meet the commitment made to the European Bank for Reconstruction and Development, the Government requested the Minister without Portfolio for the Management of National Assets in 2018 to start negotiations with the potential financial institutions for the purchase of the State's indirect majority stake in Budapest Bank for a consideration reaching or exceeding the purchase price paid by Corvinus Zrt. The related business due diligence investigations that started in 2019 are also ongoing in 2020.

7 BUSINESS REPORT OF THE MANAGEMENT

7.1 General introduction

Budapest Bank Group

Budapest Bank was established in 1987 as one of the very first domestic commercial banks. It is a key player of the Hungarian banking market, one of the eight domestic large banks. On 29 June 2015, the Bank Group was transferred to state ownership: Corvinus Nemzetközi Befektetési Zrt purchased a 100 per cent stake in Budapest Bank Zrt from GE Capital. The Bank Group's other members are the subsidiaries owned by the Bank 100 per cent: Budapest Alapkezelő Zrt, Budapest Lízing Zrt and Budapest Eszközfinanszírozó Zrt.

Managers of Budapest Bank

Name	Organisational unit	Position
Dr. Koppány Lélfai	Office of the Chief Executive	Chief Executive Officer and Chairman of the Board
Béla Csáki	Office of the Chief Executive	Deputy Chief Executive Officer for Corporate and Retail Sale
András Puskás	Office of the Chief Executive	Deputy Chief Executive for Operations, Risk, and IT
Dr. Krisztián Németh	Legal and Compliance	Head of Legal and Compliance
Dr. Kornél Barna	Office of the Chief Executive	Head of Chief Executive's Cabinet, Marketing Communications
Ferenc Alföldi	IT	Head of IT
Frigyes Lasetzky	Operations	Head of Operations and Quality
Péter Nyulasi	Risk Management	Head of Risk Management
Ákos Almási	Internal Audit	Head of Internal Audit
Dr. Csaba Sándor	HR and Communications	Head of HR and Communications
Keresztyénné Katalin Deák	Finance	Chief Financial Officer
László Somodi	Bank Security and Facility Management	Head of Bank Security and Facility Management

Bank's auditor: KPMG Hungária Kft and István Henye as registered chartered auditor. In addition to the half-yearly and annual audits, KPMG performed the following audit jobs during the course of 2019: mandatory compliance audit of mortgage loans offered for refinancing.

7.2 Results of 2019 business year

Budapest Bank Group continued its self-financing business model in 2019. At the end of 2019, the deposit portfolio accounted for 73% of the Bank Group's total funding, while refinancing funding (including deposits from banks) accounted for 14%. While total assets increased 24%, deposits increased by 26%, and refinancing funding by 30%.

Corporate deposits account for 92% of total deposits. Other deposits are comprised of the Fund managers' deposit portfolios, the Investment services settlement accounts and NFA deposits (NFA: National Land Fund Management Organisation, which provides deposits temporarily for the Bank). Finance lease liabilities (amount of capitalised real estate rentals) generated under the IFRS 16 standard are also classified as other deposits. Within corporate deposits the percentage of sight deposits slightly decreased (from 84% to 82%).
The composition of refinancing funding has significantly restructured. The weight of the Growth Credit Programme ("NHP") as refinancing funds increased (from 37% to 39%). Parallel with this, mortgage refinancing has further increased from 20% to 23% (due to compliance with the Mortgage Funding Adequacy Ratio - "JMM ratio"). The ratio of Interbank and other refinancing sources decreased.

In 2019 the Bank Group's retail credit portfolio increased dynamically: based on the gross credit portfolio, there was a 19% year-to-year increase. Within this, mortgage loans increased by 12%, unsecured loans by 33% (the newly-introduced baby expecting loan accounts for 20% of this), while the portfolio of automobile finance was 18% higher than the December 2018 closing portfolio. At the same time, the Bank continued loan sales and portfolio cleansing activities which achieved significant results in 2019.

The volume of new mortgage lending exceeded that of the previous year by 11%. In the past few years, the process of mortgage lending has been reviewed (as part of which credit assessment times were significantly reduced). The excellent position achieved with third-party partners continues to play a significant role in the development of sales results.
In harmony with the NBH's recommendation, 97% of the volume of new placements had fixed interest with interest periods of 5 to 10 years.

Long-term cooperation projects with third parties constitute an important part of the Bank's retail strategy. Our contract with Tesco Global Áruház Zrt has been renewed.
The volume of new personal loans increased by 32% compared with the year before. Thanks to an ongoing marketing campaign, including the cross-selling campaign of any-purpose loans to customers with Tesco cards, and the revival of the brokers' channel, the Bank has also managed to increase its market share compared with the previous year's corresponding period.

The volume of new automobile financing increased by 42% on a year-to-year basis, in which the restarting of the Growth Credit Programme (NHP) played a part. It is, however, also owing to a number of systematic service developments, the intensification of partner relations and partner acquisitions.

As a new strategic initiative launched in 2016, Budapest Bank Group takes part in the state land sale programme coordinated by the NFA. The Bank Group's role consists of two banking services provided on a market basis: as custodian it receives escrow funds from farmers who intend to submit bids, and later, in the capacity of intermediary, it manages the applications of awarded bidders for land loans provided by MFB Bank and handles the disbursement of loans. The Bank Group successfully closed the contract conclusion phase of the MFB-GCP Land Purchase Credit Programme in March 2017. In 2019

the Bank Group realised commission revenues worth of HUF 200 million in connection with the NFA programme.

Budapest Bank's corporate division, which primarily focuses on serving domestic small and medium-sized businesses, successfully took advantage of the period of economic prosperity, and despite extremely keen pricing and risk competition, increased its portfolio by almost 31% from the end of 2017. In the past two years, its gross corporate credit portfolio increased by 34% and its lease portfolio by 22%, respectively. Besides the background of favourable macro-economic processes, the expansion of lending was supported by the nation-wide sales network and intensive sales activities.
The Bank Group also managed to improve its positions in transaction banking: in the field of newly opened accounts, the Bank Group achieved the second position among its competitors. Foreign currency conversion activities are assisted by the Treasury belonging to the corporate division and as a result, there is even closer cooperation between the two units.
The corporate strategy continues to focus on the SME segment accounting for almost 85% of its loan portfolio. In 2019 there was a minor decrease in the percentage of the segment of large corporates (from 21% to 16%).

The Bank Group continues to make emphasis on technological innovations: in 2018, the launch of Budapest Bank's Mobile Payment service was an important milestone in the implementation of the digital strategy. In 2019, several developments were implemented: the new, modularised version of Budapest Internetbank was commissioned, in consequence reduced maintenance time is necessary for going live and introducing new functions, and during migration there is no need to temporarily shut down the entire Internet banking facility which in turn significantly improves customer satisfaction. Both the mobile application and the Internet banking website have been renewed, including the technology behind the website.

At the end of last year, Budapest Bank Group's network consisted of 94 branches. The branches located in the territory of Budapest qualify as establishments, while the branches operating outside of Budapest qualify as branch offices.
In accordance with the statutory regulations, a Works Council is operational at the Bank Group. Employment policy decisions are always made in agreement with the Works Council.

During the demerger process from GE, in addition to establish self-funding, another great challenge the Bank Group faced was the replacement of the various systems supplied by GE. The last major demerger project, the card system transition was successfully implemented in 2018. The Bank Group took all necessary measures to satisfy the conditions of the instant payment system launch in March 2020.

7.3 Asset quality and portfolio

In 2019 the Bank Group's total assets increased significantly, from HUF 1,237 billion to HUF 1,531 billion. Liquid assets, low-risk government securities and loans to banks amounted to HUF 544 billion on 31 December 2019. This sum represents 35% of the total assets.

The net portfolio of loans provided for customers (lending) increased significantly and amounted to HUF 928 billion by the end of 2019. During 2019 the Bank Group continued to place the main business emphasis on the portfolio of small and medium-sized enterprises. Similar to the year before, the Bank achieved second place among large banks as regards the number of newly-opened SME accounts, by taking advantage of the cross-selling opportunities offered by MFB points. The Bank's corporate credit

portfolio placed with small and medium-sized enterprises, calculated without impairment and including leases, amounted to HUF 540 billion which demonstrates the key role of this segment in the Bank's strategy.

The Bank's retail credit portfolio reached a significant level of HUF 437 billion, excluding impairment.

During 2019, the amount of allowances made for loan impairments decreased significantly, from HUF 62 billion to HUF 49 billion in consequence of the improving portfolio quality which, on the whole, represented a 5% allowance / gross receivables coverage ratio at the end of 2019.

The Bank made all the required impairment allowances and provisions.

7.4 Asset-liability structure and liquidity

The Bank's foreign currency-based placements and liabilities decreased significantly in 2015 due to the mandatory statutory forint conversion of mortgage and automobile loans.
15% of the total assets are denominated in foreign currency (19% in 2018); the majority of foreign currency assets are denominated in EUR, USD and CHF.

14% of the total liabilities (18% in 2018) are denominated in foreign exchange; the majority of foreign liabilities, too, are denominated in EUR, USD and CHF.

Due to the Bank's risk-avoiding business policy, foreign exchange fluctuations can affect the Bank only to a moderate degree in the absence of material open foreign exchange positions. The Bank did not have material open foreign exchange positions at the end of the year.

The Bank continues to have an outstandingly highly-liquid asset portfolio, and as a result, it is in a long-term interbank lending position on the Hungarian money market. Cash and equivalents, loans to banks and securities account for more than 30% of the total assets. Its total assets maturing within a year amounted to HUF 718 billion; by contrast, liabilities maturing within a year amounted to HUF 666 billion which represents a HUF 52 billion positive net asset surplus position in this segment.

By using a risk-avoiding pricing, the Bank managed interest rate risks, arising from the different repricing of assets and liabilities, at a pre-defined level. The Bank continuously monitors interest rate risks on a transactional level for the entire balance sheet and assesses them with stress tests. Since 2016, in order to reduce the interest rate risks of the increasing portfolio of fixed-interest assets (both securities and individual loans), the Bank has concluded interest rate swap transactions.

Overall, Budapest Bank maintained a very high level of liquidity, cash flow and interest rate management practice throughout the year.

7.5 Capital position

In 2015 there was a change of owners at Budapest Bank. Corvinus Nemzetközi Befektetési Zrt proceeding on behalf of the State became the 100% owner of the Bank. The change of owners did not affect the Bank Group's stable capital position; its issued capital amounted to HUF 19,396 million. At

the end of 2019, the Bank Group's equity, together with the current-year profit of HUF 11,571 million, amounted to HUF 164,841 million.

The Bank has created a general reserve of HUF 6,562 million from its yearly profits as required under the Hungarian legal rules in recent years, and payed dividends to its owner worth HUF 3,251 million in 2019 which did not change the Bank's strong capital position and business growth potential.
The Bank Group's capital adequacy ratio is 15.14% which is above the 12.87% prescribed by the central bank as a mandatory requirement.
In 2019 the Bank Group's Basel III and IFRS-based regulatory capital amounted to HUF 148,856 million (HUF 140,998 million in 2018) which complies with the relevant rules. The change of the regulatory capital (HUF 7,858 million) is the net result of the rise of reserves (+ HUF 8,320 million), the deduction of increasing intangible assets (HUF 2,814 million) and the change in the valuation adjustment. During the course of capital management, the Group continuously tracks the development of the individual capital elements.
The portfolio of risk-weighted assets – including operational and market risks – increased from HUF 917,461 million at the end of 2018 by 7.19% to HUF 983,429 million. The rise in risk-weighted assets is mainly due to the increase in the Bank Group's lending activities. The fall in the operational risk capital requirement is due to the strengthening control of processes.

7.6 Profitability

Also in 2019 the Bank Group achieved an outstanding profit rate, above its business plan. The Bank Group's profit for the year is HUF 11,571 million which is a HUF 968 million decrease compared with the year before. The enclosed income statement was prepared according to the rules of accounting both for 2018 and 2019.

data in HUF M

Income statement	2019	2018	Delta	%
Net interest income	42 954	36 963	5 991	16.2%
Net fee and commission income	38 961	33 886	5 075	15.0%
Profit/loss of financial instruments	872	3 064	(2 192)	-71.5%
Other revenues/expenditures, net	(15 862)	(13 534)	(2 328)	17.2%
Operating expenses	(51 034)	(47 891)	(3 143)	6.6%
Impairment	(1 625)	2 470	(4 095)	-165.8%
Income (profits) tax	(2 695)	(2 419)	(276)	11.4%
Profit for the year	**11 571**	**12 539**	**(968)**	**-7.7%**

Primarily the following items were responsible for changes in the profit/loss lines:

- On a year-to-year basis, the Bank's net interest revenues increased by HUF 6.0 billion primarily due to the dynamically increasing credit volumes.

- The 15% increase in net fee and commission profits mainly arises from the fee and commission income of current accounts and tied-up deposits which increased parallel with credit volumes.

- The profit of financial instruments decreased by HUF 2.2 billion compared with the year before. In 2018, a favourable one-time item improved the profit significantly – the initial fair value of interest rate swaps concluded as part of the MIRS programme.

- The deterioration in net other expenditures primarily arises from the higher transaction duty resulting from a rise in sales.

- The increase of operating expenses was caused mainly by progressive pay rises, the demerger from GE and a higher depreciation charge due to the strategic projects.

- In 2019, the rate of impairment recognition exceeded the rate of release; however, it only amounted to 0.2% of the end-of-year gross loan portfolio.

On the whole, not only the operations of the Bank Group were profitable in 2019, but also those of most of the subsidiaries. Budapest Lízing made HUF 1,089 million profit for the year, Budapest Alapkezelő achieved HUF 2,036 million profit for the year, while the loss of Bp. Eszközfinanszírozó amounted to HUF 425 million.