

ANNUAL REPORT OF  
**MKB GROUP | 2017**



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## CHAIRMAN'S GREETING

MKB underwent intensive transformation after 2014. The transformation period was followed by the reconstruction of the business areas with the dynamisation of our traditionally strong corporate business line, while in the Hungarian retail segment we moved forward with a uniquely brave opening in digital space. The macroeconomic conditions supported the development of the banking sector. The favourable banking market trends - such as rising lending, consistent clean-up of non-performing portfolio - benefitted the whole banking sector and contribute to its future development, but also open up new opportunities for us.

As of 2018, considerable new challenges will have to be resolved, such as the unprecedented shortage in available workforce and labour market competition in Hungary. While interest rates are at record lows, accompanied by low market volatility, the increasing competition limits the banks' profit generating capacity.

Following a successful reorganisation, we formulate our strategy by deliberately exploiting our strengths and opportunities in order to be successful with a stable and sustainable business model built upon a strong foundation as a universal financial group.

With the implementation of our strategy built upon cooperation we offer our customers an exceptionally wide range of services.



Through our continuous innovation and integration efforts, we can achieve a successful breakthrough in the retail business, while simultaneously improving further our positions in the corporate and investment services.

Finally, I wish to take this opportunity to thank our customers, partners and owners for their trust and support and to commend the staff and the members of the Board of Directors and Supervisory Board of MKB Group on their committed and effective work over the past year.

**János Jaksa**

*Chairman of the Board of Directors  
of MKB Bank Zrt*

# MANAGEMENT REPORT

2016 was a year of successful transformation of MKB as the group became profitable again after 6 years. In 2017, we were able to build upon this successful operation and we can claim that last year was one of the most successful periods in the bank's history: the group further stabilised its foothold and strengthened its position.

To ensure that MKB shall not be only the bank of traditions, we continue with our digital development efforts. Our aim is to preserve MKB's position as one of the most innovative players in both the Hungarian and regional banking market. Our FinTech Academy, digital achievements and incubation programmes are all elements of a strategy with which we are building a digital company for the future. The mission of MKB Financial Group is to attend to the needs of our partners with professional and secure servicing. For this reason, we rely on continuous development, apply the most secure technologies and we strive to operate Hungary's most advanced data management and analysis technologies. Following the HUF 7.8 billion profit in 2016, MKB Group managed to more than double its earnings in 2017, generating a pre-tax profit of HUF 20.7 billion. This is the strongest performance over the past 10 years.

We were successful with the corporate lending incentive programs rolled out by the National Bank of Hungary, while in the retail sector MKB's continuously increased new disbursements outpaced the sector average: housing loans grew almost by 140%, while the disbursement of new personal loans doubled. By



improving profitability, the Group's capital position strengthened further: the consolidated capital adequacy ratio under Basel III reached 15.73% (vs. 12.04% in 2016). Furthermore, compared to the profitability and risk related to our assets and operations, a moderate total operational risk model characterized the group in 2017. In addition to the steady downsizing of the commercial real estate loan portfolio, we also made great progress in cleaning of the retail non-performing loan portfolio, as a result of which the ratio of non-performing loans dropped significantly, approaching the banking sector average.

With reference to the gradual improvement of financial fundamentals, more specifically the continued decrease in non-performing loans and improving profitability, Moody's credit rating agency also recognised our efforts and upgraded MKB's rating at the end of June.

The main achievements of 2017 are considered to be the opening of 35 MFB Points in our countrywide network, gaining 9%+ of the market share in the combined three stages of the Funding for Growth Scheme, taking more than 20% of the market share in the financing of the Széchenyi Programme in 2017, the launch of the MKB Agricultural Partnership Programme and the expansion of our simplified loan procedures, while we managed to further develop our daily operational mechanisms. Furthermore, we introduced and successfully continued the largest HR programme in the history of our Bank, which was designed as a modern and competitive value offer to our employees. We are also proud that due to the increasing trust of our customers we have increased the assets under management in the Private Banking business line by HUF 80 billion.

We believe that it is the way we approach and serve our customers that distinguishes us from our competitors. We are proud that we continue to retain MKB's standing as the best in customer satisfaction in 2017.

The subsidiaries of MKB also closed a remarkably successful year in 2017: MKB-Euroleasing grew into Hungary's dominant leasing company, Fintechlab, founded by MKB, is considered to be Hungary's most dynamic financial innovation lab recognised at regional level as well, while MKB Consulting got into the top 3 players in the Hungarian tender advisory market in just 2 years following its foundation. MKB-Pannónia Investment Fund, founded with the participation of MKB Bank, is now among the 5 largest players in the Hungarian market; with almost HUF 600 billion assets under management.

MKB Group believes in the power of cooperation built on mutual benefits, which lead us to successful strategic agreements with

CIG Insurance Company, agricultural players, law enforcement organisations and fintech partners.

2017 was a year of strategy making. The so-called "MKB 2021" concept drawing up the Group's mid-term strategy was formulated, taking into account the specificities and trends of the domestic business environment, together with the bank's strengths and opportunities. By realizing the strategy, MKB was able to become a prosperous financial group, based on effectively implemented digitalisation and functioning with a dynamic organisational model. It is an important element of the strategy that the bank would be introduced to the regulated capital market as the third Hungarian financial institution.

MKB Group is on a dynamic trajectory of development and it is able to continuously progress and grow. Our successes reached so far – thanks to the excellent work of our employees, the commitment of our partners and the continuous cooperation with our partners – have given us a solid base to meet our objectives.

The 69 units of our nationwide branch network including 35 MFB Points, our 19 dedicated mid company and 10 private banking consultation centres, 500 leasing partners, 1,200 external sales partners and two thousand employees work from day to day to achieve our common objectives.

**Dr. Ádám Balog**  
CEO, on behalf of MKB Management

## STRATEGIC PRIORITIES

### VISION

MKB Group values its customers and employees as partners. We believe in the converging power of cooperation and mutual results. Our everyday work is based on traditional banking values and expert advice. Our continuous banking innovation secures that we provide the most developed services to our customers. Our operation model is regularly optimised and shaped to remain tailored to our partners' needs.

### MISSION

The mission of the MKB Group is to provide high standard, quality services to our partners based on mutual advantage while securing safety. As one of Hungary's major traditional banks, MKB Bank is committed to fostering the economic and social developments of the country. The respect for traditional banking values and the commitment to being a leader in innovative financial solutions are both simultaneously present in our operation.

Apart from our banking products and services, we offer an exceptionally wide range of services to our subsidiaries and partners, thus enabling MKB Group to provide full-scale financial services to private individuals and companies.

We consider honesty, fair banking operation and partnership-based cooperation as important factors.

**Tradition, Innovation and Cooperation are deemed to be our basic values.**



## MAIN INDICATORS

Data in HUF million, unless indicated otherwise

BALANCE SHEET	MKB Group (IFRS consolidated)			
	(million HUF)		(million EUR) <sup>9</sup>	
	2016	2017	Change	2017
Total assets	2,101,616	2,044,987	-2.7%	6,594
Loans and advances to customers <sup>1</sup>	858,072	858,592	0.1%	2,768
Investments in securities	924,137	902,712	-2.3%	2,911
Customer accounts and deposits	1,519,868	1,539,140	1.3%	4,963
Shareholder's equity	125,408	140,380	11.9%	453
<b>INCOME STATEMENT</b>				
Gross operating income <sup>2</sup>	67,307	80,746	20.0%	261
General administrative expenses	(38,283)	(48,685)	27.2%	(157)
Impairments and write-offs	(15,236)	(9,611)	-36.9%	(31)
Banking tax	(6,257)	(2,101)	-66.4%	(7)
Share of jointly controlled and associated companies' profit / (loss) before taxation	273	389	42.5%	1
Profit / Loss before taxation	7,804	20,738	165.7%	67
Profit / Loss for the year	9,496	19,201	102.2%	62
<b>LIQUIDITY &amp; SELF FINANCING</b>				
Loans-to-Deposits (LTD) Ratio <sup>2</sup>	56.5%	55.8%		

**MKB Group (IFRS consolidated)**

(million HUF)

<b>CAPITAL MANAGEMENT</b>	<b>2016</b>	<b>2017</b>
Capital adequacy ratio	12.04%	15.73%
<b>PORTFOLIO QUALITY</b>		
Total Risk Weighted Assets (RWA) <sup>3</sup>	936,804	930,751
Non performing exposure ratio (NPE) <sup>2, 4</sup>	11.7%	6.9%
Nonconsolidated non performing loan ratio (NPL) <sup>2, 5</sup>	14.5%	6.1%
NPE coverage % <sup>2, 6</sup>	66.3%	72.1%
NPE coverage incl. collateral % <sup>2, 6</sup>	92.7%	95.2%
<b>PROFITABILITY</b>		
After tax ROAE <sup>2</sup>	6.4%	14.2%
After tax ROAA <sup>2</sup>	0.5%	0.9%
<b>EFFICIENCY AND OPERATION</b>		
CIR <sup>2, 7</sup>	56.8%	55.6%
Number of average statistical employees	1,996	2,031
Number of branches	73	69

1 net amounts

2 data not represented in MKB's Financial Statements

3 including operational and market risk

4 according to CRR 178., default rating based, includes off balance sheet items

5 DPD90+

6 default rating based

7 corrected with restructuring costs

8 HUF/ EUR exchange rate: BS: 310,14; PL: 309,21

## OPERATING ENVIRONMENT

### INTERNATIONAL MACROECONOMIC ENVIRONMENT

In terms of global economy, 2017 was characterised by gradually improving macroeconomic figures, low volatility, persistently low inflation expectations and the related monetary policy dilemmas.

The Fed raised interest rates three times, respectively in March, June and December and, in October 2017, began to gradually reduce its approximately USD 4,500 billion balance sheet, effectively stepping on the path of quantitative tightening. In the last month of the year, investor sentiment was shaped mainly by expectations related to a US tax overhaul.

At the same time, the ECB and the Japanese central bank decided to extend their asset purchase schemes in 2018, which further increased the global liquidity surplus. In the Eurozone, business climate indices hit six-year records during the year, while the modest inflation expectations confirmed the continuation of the loose monetary policy. In the first half of the year, the European political risks dropped significantly. However, in the last month, the stalling negotiations in reorganizing the Catalan and German government cast a shadow on the overall picture. The Brexit talks entered into a new phase at the end of 2017, focusing on the issues of transition and the system of relations that will follow the UK exit.

In January 2018, the International Monetary Fund revised upwards its forecast for global economic growth in 2018-2019, projecting 3.9% global growth for both 2018 and 2019, which is

0.2 percentage points higher than the prognosis published in October 2017. According to the IMF, the risks of global growth, driven mostly by the economic performance of the developing countries are balanced in the short term, but in the medium term the geo-political tensions, political uncertainties and the surfacing protectionist tendencies of certain countries may overshadow the picture.

### DOMESTIC MACROECONOMIC ENVIRONMENT

In 2017, the average GDP-growth was 4.0% in Hungary, with the expansion fuelled by accelerating capital investments and a favourable external business climate. Due to the major sports events held in the summer, tourism and services grew dynamically, while the construction industry benefitted from the increase in EU projects and housing and office construction projects. Consumer prices rose on average by 2.3% in 2017. The volume of savings also grew owing to the wage contribution cuts and minimum wage increase: the financial assets held by residents expanded by 7.5% on an annual basis in 2017. Household spending was also up in 2017. The unemployment rate stabilised at a low level and the shortage of labour in certain sectors increased further in the second half of 2017.

In 2017, the National Bank of Hungary gradually reduced the three-month deposit portfolio (from HUF 900 billion at the beginning of the year to HUF 75 billion by December) without changing the reference rate. A number of new components were added to the unconventional monetary tool-

set. In the first half of the year, the central bank introduced 6 and 12-month FX swap tenders which could contribute to maintain an abundant liquidity for an extended period in the inter-bank market. Due to this measure the Hungarian short-term inter-bank rates fell to approximately zero level. In November 2017, decisions were taken to introduce two new unconventional tools aimed at maintaining the loose monetary policy.

In 2017, the EUR/HUF exchange rate fluctuated around the 309 level with moderate volatility (on average 309.24).

## OVERVIEW OF THE BANKING SECTOR<sup>1</sup>

The favourable profitability trends of the Hungarian credit institution sector continued in 2017: the credit institutions reported HUF 694.0 billion profit before tax in 2017, which was up by 38% compared to the already record-high profit before taxation booked in the same period of the previous year. However, such a high profit level was partly the result of one-off, non- or almost non-repetitive items and structural impacts, such as reversed impairment or the effect of reduced banking tax following the stabilisation of the budget. Due to the favourable macro-economic environment, portfolio cleaning and the significantly better quality of extended new loans, impairments and provision were released, improving the P/L. In the credit institution sector, the ratio of loans overdue for more than 90 days sank to 7.6% in the household portfolio and dropped to 3.3% in the non-financial corporate portfolio.

In 2017, the capital requirements for banks were raised: apart from the increase in the capital maintenance buffer, a capital buffer was also introduced for other systemically significant institutions, in addition to a systemic risk

capital buffer for non-performing project loans. Beside these measures, the capital position of the banking system still remains stable; at the end of 2017 the capital adequacy ratio was at 20.5%, while the historically high profits could further increase the capital buffer of the sector.

At the end of 2017, the total assets of the credit institutions were close to HUF 36.4 thousand billion. The net loan portfolios of both domestic non-financial companies and households expanded by 12.7% and 4.6%, respectively. The lending practices of the corporate segment were supported by the favourable macroeconomic trends, low interest rates and the continued Market-based Lending Scheme (MLS). At the same time, in the retail business the increasing consumption, improving labour market trends, a growth in real-wages due to the low inflationary environment and the dynamic housing market gave momentum to both housing and personal loans.

MKB expects the banking system to further reinforce its position: the favourable tendencies in lending will continue, while demand for investment and consumption will drive increased borrowing in the retail and corporate segments. In terms of profitability, an increase in lending mitigates the effect of the low interest environment.

Numerous innovations were introduced in 2017 and are on-going in the banking sector for which customers are the direct beneficiaries: the digital transition, including the future introduction of an instant payment system means faster, more efficient and cheaper products and services for customers, while the certified consumer-friendly housing loan developed by the National Bank of Hungary strengthens the banking system competition and increases the transparency of loan products and their comparability.

<sup>1</sup> Source of data: National Bank of Hungary (MNB), preliminary data; changes against comparative data (HAS and IFRS cumulative data)

## MKB GROUP'S PERFORMANCE IN 2017

In 2017, MKB Group continued to strengthen its business fundamentals and had a stable capital position, liquidity, funding structure and performance in its business lines, while it managed to reach considerable improvement in risk indicators as well.

Following the outstanding profit reported for 2016 (HUF 7.8 billion), in 2017 the group more than doubled its earnings, reporting HUF 20.7 billion pre-tax profit. Core business results grew slightly with 2.3% higher interest income and commission & fee income up by 0.6%, which altogether made up a significant portion (84%) of the gross profit. The group reported HUF 10.2 billion 'other' operating profit in 2017, primarily due to higher profits gained from revaluation/sale of instruments in securities and lower banking tax rates.

Impairments and provisions dropped by HUF 5.6 billion against the previous year; in total HUF 9.6 billion net provisions were recognised in 2017. The ratio of 'non-performing' exposure (NPE<sup>2</sup>) fell significantly from 11.7% seen at the end of 2016 to 6.9%, while the ratio of non-consolidated 'non-performing' loans (NPL<sup>3</sup>) - including loans overdue 90+ days - dropped from 14.5% to 6.1%. This was the result of the successful continuation of the non-performing portfolio reduction strategy introduced in previous years and the lack of any major new default event in the expanding

economic cycle of 2017. The positive developments in portfolio quality were also attributable to the stringent and consequent risk management measures effective since the beginning of the portfolio clean-up, contributing to the improving quality indicators of the new loan portfolio. The coverage indicators of the problematic loans improved further and



<sup>2</sup> according to CRR 178., consolidated NPE% (default rating based) includes off balance sheet items  
<sup>3</sup> Non-consolidated NPL% (DPD90+)  
<sup>4</sup> The EU commitments forming part of the Restructuring Plan approved by the European Commission

considerably lower provisions had to be set aside for the projected loan losses of problematic and non-performing portfolios compared to the base year of 2016. The exposure of the commercial real estate (CRE) financing segment continued to decrease to such an extent that MKB managed to fully meet its obligations by the end of 2017. Thus MKB has no further obligation to decrease the portfolio of CRE deals. The volume of problem loans are below the threshold above which additional capital reserve must be generated in relation to the capital buffer requirements for systemic risk introduced last year. A large-scale project was introduced in 2016 with an aim of reducing the retail non-performing loan portfolio. The bank introduced numerous measures in the project, including launching campaigns to restructure or close deals and to sell the portfolio. At the end of 2017, MKB Bank entered into an assignment contract as a result of which two-thirds of the retail non-performing portfolio was sold. As a result of the ensuing implementation at the beginning of 2018 a large number of loan receivables and accounts with negative balances were derecognised from the books, while the sale of the remaining portfolio is likely to be completed during the course of 2018.

The implementation of MKB Group's strategic objectives requires considerable investments, while it took further financial burdens to meet legislative obligations such as IT-related de-

velopments, increasing payroll expenses due to tightening labour market competition, and the higher legal and advisory costs related to the release of the non-performing portfolio. All these resulted in increased bank operating expenses amounting to HUF 48.7 billion in 2017.

The total assets of the MKB Group decreased by 2.7% year on year, amounting to HUF 2,045.0 billion on 31 December 2017. At the end of 2017, the receivables from customers stagnated in comparison to the previous year, amounting to HUF 858.6 billion. In terms of composition, although the volume from new lending increased significantly, regrouping according to accounting standards had to be simultaneously performed as regards the non-performing portfolio. On the liability side, the total volume of the current and deposit accounts of customers showed 1.3% growth, i.e., HUF 19.3 billion increase versus the end of the previous year and reached HUF 1,539.1 billion by the end of the specific period.

With improved profitability, the capital position of the Group also became stronger hence the consolidated capital adequacy ratio according to Basel III rose to 15.7%. On 31 December 2017 the Tier 1 capital of the Group was HUF 146.4 billion based on Basel III IFRS under supervisory regulation. Risk-weighted assets including operational and market risk decreased by 0.65%, from HUF 936.8 billion in 2016 to HUF 930.8 billion.

## PERFORMANCE OF THE INDIVIDUAL BUSINESS LINES<sup>5</sup>

### RETAIL SEGMENT

The strategy conceptualized in MKB 2021 aims to place the retail business line on a robust growth trajectory and increase customer numbers, at the early phase relying partly on corporate affiliations and strategic co-operations of MKB, and with due time building upon the on-going digital developments and Fintech incubation programs. This objective is supported by the improved processes, intensive product development and steps towards enhancing the digital customer experience, which enables the bank to provide retail customers more complex offers and a more complete product and service range. MKB is constantly developing its digital services in order to enable its customers to manage their finances faster and more effectively 24 hours a day.

It is a good indication of MKB Bank's solid gain in market share that the number of acquired new customers reached almost 20 thousand, which is 40% higher year on year, while the number of customers leaving the bank dropped to one-third.

More than 21 thousand customers joined the MKB Plaza loyalty scheme established at the end of 2016, benefiting from the preferential terms and conditions offered by more than 150 partners.

In 2017, there was a rapid rise in new loans extended by the Bank to retail customers: the disbursed mortgage loan portfolio grew to almost 2.5 times of the previous level, and the disbursed personal loans doubled year on year. The majority of the retail loans are

secured: 91% of the portfolio is made up of mortgage loans for housing purposes and all purpose mortgage loans.

The household assets managed by the Bank exceeded HUF 740<sup>6</sup> billion by the end of the year. The transformation of the structure of savings continued to follow the specificities of the low interest rate environment: while the share of term deposits and bonds was gradually decreasing, the assets in investment funds and government securities were rising.

In addition to its national network of 69 branches (24 branches in Budapest and the surrounding metropolitan area and 45 branches in the countryside), the Bank uses external sales channels to sell its products. In 2016 the Bank enhanced sales through loan intermediaries, as a result of which MKB Bank became a dominant player in the sale of mortgage loans and small corporate products.

### DIGITALIZATION /ALTERNATIVE SALES CHANNELS

It is MKB's outstanding strategic goal to become Hungary's leading digital bank. Further significant steps were taken in 2017 to achieve this goal: the Bank was first to introduce a number of developments in the market. The number of customers banking digitally has been constantly rising; at the end of the year two-thirds of customers were using digital channels.

<sup>5</sup> Source of market share data: MNB, MKB own calculation

<sup>6</sup> Deposits + Bonds + Investment Funds + Government securities



In April 2017, MKB Bank was the first in Hungary to introduce the mobile wallet service called MKB Pay. In Hungary, mobile wallet payment is considered to be in its early phase, but it is developing robustly and so it may soon become a preferred payment method. The use of MKB Pay also reflects the same tendency: more than 10% of the customers banking through their mobile phones already use the application.

Beating all its competitors, MKB was among the first ones to launch online account opening which was one of the greatest novelties in 2017. Following a video chat identification not only can a bank account be opened, but via the application of MKB Pay, customers can also immediately start using the bank cards attached to their accounts with the help of the MKB Pay application. In 2017, MKB Bank was exclusively the only bank offering instant bank card virtualisation to its customers.

In 2017, the number of mobile bank application users more than doubled, which means that 25% of digitally banking customers used their smartphones for banking. A number of new functions were added to the application in two phases, in the spring and in the autumn: with a unique option, customers can login through a push message and approve transactions on the web portal of MKB Bank, the Netbankár.

MKB Bank was the first financial institution in Europe to introduce facial recognition based identification, significantly enhancing security in mobile banking.

MKB was also the first bank in the Hungarian banking sector to introduce online application for mortgage loan offers for retail customers, significantly shortening and simplifying administration.

At our website which was further optimized in 2017, the number of new visitors doubled.

Other developments impacted operations which are less visible for customers. In 2017, the Bank placed special emphasis on changing the core system (Flexcube) of the Bank (becoming fully operational in 2018) and the optimization of business processes. These developments contributed to a large extent to a more rapid, comfortable and simple process of customer administration, while enhancing customer experience.

## CORPORATE AND INSTITUTIONAL BUSINESS

Based on MKB 2021, the strategic aim of MKB Bank, building upon on its traditional values, is to maintain a strong corporate business line focusing on local knowledge and professional servicing, advisory-based sales and orientation for innovative banking solutions.

In 2017, MKB focused increasingly on small and medium-sized enterprises, beside the traditional large corporate segment. It facilitated the expansion of the Bank's small corporate business that all corporate customers irrespective of size are served within the same business line. This structure secures that MKB can provide its customers with uniformly consistent, high quality and effective services, monitoring their development.

Following a successful public procurement procedure, in the summer of 2017 MKB Bank signed an intermediary agreement with the Hungarian Development Bank (MFB) for the establishment of 35 MFB Points (of sales) within the MKB branch network for the intermediation of MFB products and to enable customer access to refundable and non-refundable financing with rather favourable conditions. More than 200 trained colleagues manage customer requests at the MFB Points opened by MKB. By the end of the year, the

processing of transactions to the tune of more than HUF 8.5 billion began to take place, and the first disbursements were also made.

In the first quarter of 2017, MKB Bank continued its successful involvement in phase 3 of the Funding for Growth Scheme (FGS) of the National Bank of Hungary, made further commitments in phase 2 of the Market-Based Lending Scheme (MLS), and significantly exceeded its overall MLS commitment. In addition, it also placed significant funds from the products offered by EXIM within the framework of its Export Promoting Credit Programme (Hungarian abbreviation: EHP).

Financing products include card, working capital and investment loan facilities offered in the Széchenyi Programme. MKB Bank has played an outstanding role in the success of the Széchenyi Card Programme from the very beginning. By raising the maximum amount of the available loans to HUF 100 million, as from last year more flexible larger credit facilities have been offered which, combined with other MKB Bank products, create a sound financial basis for micro, small and medium-sized enterprises. On the basis of the financing provided via the programme in 2017, the Bank had 20.3% market share, which secures the Bank a stable second position in the market. The Agricultural Széchenyi Card instrument launched in 2016 must also be highlighted, as lending performed by the Bank in 2017 amounted to approximately HUF 31.5 billion within this framework.

In 2017, the Bank aimed to provide the agricultural sector with professional services such as key programmes, special financial products designed for the sector and expert advice. In order to promote the effectiveness of expert advisory services and to provide professional support, the Bank entered into a strategic agreement with the Hungarian Chamber of

Agriculture (NAK) and the National Association of Agricultural Machine and Equipment Distributors (MEGFOSZ).

Apart from the considerable achievement reached in the sector of small and medium enterprises, MKB Bank maintained its strong market positions in the large corporate segment, placing great emphasis on meeting customer needs suited effectively to individual requirements.

## INVESTMENT SERVICES

MKB Group offers a wide range of investment banking services: treasury (commission trading, depository services and sales), fund management, capital market and transaction consulting, Private Banking, tendering and project management consulting, and the recently launched venture capital fund management.

The experts of the Analysis Centre have supported the activity of MKB Group and its clients for three years. The team altogether bears almost 70 years of professional experience in macroeconomic, bond, security and FX analyses. This professional activity is key to enabling the customers of MKB Group to tap financial resources or place deposits at optimal rates and to opt for the best possible investment opportunities tailored to their needs.

Apart from the funds of MKB-Pannónia Investment Fund Manager offering a wide range of investment options, the products of five foreign and three Hungarian partners were also available in the various customer segments. The sale of structured bonds and certificates was also added to the traded investment funds, thus expanding the spectrum of investment products.

MKB is a primary contracted distributor of institutional and retail government securities. In the framework of a distribution agreement, the Bank also sold bonds on behalf of the Student Loan Centre, the Hungarian Development Bank and FHB.

In 2017, in the futures FX section of the Budapest Stock Exchange, MKB became a stock exchange member with the second largest turnover.

MKB became a NOMAD (Nominated Advisor) in the recently founded SME market (XTend) of the Budapest Stock Exchange at the end of last year, with regular analyses in relation to Alteo and Masterplast shares.

In 2017 MKB Bank managed four public capital market transactions, thus covering all public purchase offers in the Hungarian capital market.

At the end of 2017, the National Bank of Hungary approved MKB's public issuance programme up to the amount of HUF 100 billion.

## PRIVATE BANKING AND PREMIUM SERVICES

In 2017, MKB Private Banking further strengthened its market positions. The business line managed more than HUF 420 billion worth of assets of almost two thousand customers, which corresponds to a HUF 80 billion increase against 2016. With that performance, the Private Banking business line made it into the top three players in the market. The average size of HUF 236 million assets managed for a single customer stands out significantly from the market average. The opportunities involved in the cooperation between MKB Private Banking

and MKB-Pannónia Investment Fund Manager may bring further important developments in investment banking, while the developments incubated in MKB FintechLab will also grant access to innovative services.

The assets managed by Premium Investment Services launched in 2016 reached HUF 100 billion by the end of 2017. Premium investment services include customised model portfolio-based investment consultancy and a broad array of products, customised products and personal liaising with highly qualified experts.

## SERVICE QUALITY AND CUSTOMER SATISFACTION

Customer satisfaction is a fundamentally determining factor in our operations. The Bank is engaged in constant dialogue with its customers and regularly monitors their level of satisfaction.

MKB Dialogue, an online Q&A community platform created for MKB customers was launched in 2017 with an aim to represent customers and to ensure that customer opinion is integrated into the everyday operations of MKB, be it a new product launch or the approval of a new online solution.

MKB's operation is focused on enhancing customer experience.

According to the results of a complex customer satisfaction survey conducted in the autumn of 2017 involving a number of business lines/segments via questioning thousands of individuals, the Bank's efforts paid off since the conducted research indicates that a large number of customers would happily recommend MKB.

## SUBSIDIARIES AND STRATEGIC PARTNERS

In addition to our own banking products and services, the product range offered by our subsidiaries and strategic partners is also very important. Our aim is to strengthen the market position of our subsidiaries and strategic partners, to strengthen intra-group cooperation and to enhance and improve ancillary financial services.

## MKB GROUP

### MKB EUROLEASING GROUP<sup>7</sup>

Based on new financing volumes which surpassed by almost 25% the 2017 Plan, MKB-Euroleasing solidly maintained its position and continued to be one of the top three market-leading leasing companies; it became the market leader in the agricultural machine financing segment in Q1 2017 and maintained its second position in retail vehicle financing, and at the same time, it also managed to become one of the largest market players in financing of large commercial vehicles. With a solid basis for building a diversified portfolio, the Group has an optimistic outlook for 2018, expecting an increase in the volume of new loans and further strengthening of its market position.

At MKB-Euroleasing group, the processes are developed based on the Kaizen methodology, integrated deeply into the operation of the organisation. The continuous, gradual development



taken in small steps is one of the fundamental principles of the methodology. 2017 was declared the year of Kaizen, and therefore almost 500 proposals were collected during the year, most of which were actually implemented. Simultaneously with process development, major product development activities also took place, as a result of which lease products became available in the general machine financing segment, in addition to being the first to offer open-ended financial lease products to customers in the market. The complex vehicle-financing instrument launched in the autumn of 2017 allows both companies and private individuals to use the servicing options integrated into the financing. With the dissemination of that product in the market, more and more customers can have access to a more economical and flexible option in complex vehicle fleet management combined with long-term lease.

MKB-Euroleasing is also seen as one of the best workplaces, since in 2017 it received the AON Best Workplace award. Where people love to work, customers can count on the highest possible service level.

<sup>7</sup> Market data source: Hungarian Leasing Association

## MKB CONSULTING

Just two years after its foundation at the end of 2017, MKB Consulting had become a major player in the tender and financial consultancy market. Concerning the tendering business line, the company helped 260 customers within its small corporate portfolio to gain access to approximately HUF 1.5 billion worth of assistance during the year, while the key corporate customers of the company were granted HUF 11 billion assistance through successful applications dedicated mainly to research-development and innovation.

MKB Consulting provides advisory services in the field of fund-raising for various institutional entities, such as towns with county right, the Budapest Stock Exchange (BÉT) and key equity fund managers. In 2017, MKB Consulting was the first in Hungary to come up with a unique urban development and financing model for a dynamically developing Hungarian town to facilitate the long-term economic development of the settlement also functioning as a county seat including its direct agglomeration using HUF 25 billion worth funds.

Within the framework of fund raising through the equity market, the company worked for almost eighteen months to launch the National Exchange Development Fund with HUF 20 billion share capital which, according to the plans, could support financing for at least four new companies a year in making their way to the Budapest Stock Exchange. Besides this flagship project, the advisory activities of MKB Consulting also contributed to the BÉT training and stock exchange preparatory projects to be implemented from 2018.

## MKB INKUBÁTOR KFT. /MKB FINTECHLAB

We believe that large companies and start-ups complement each other. MKB, therefore, as the first Hungarian bank opened up to the world of start-up, technology and innovation (and now with MKB Fintechlab, i.e., its innovation laboratory and start-up incubator), has become a dominant actor not only in the Hungarian, but in the regional market as well.

MKB Fintechlab supports the strategy of MKB Group through three pillars: it builds up a community leading in innovation around MKB Group, supports start-ups within the framework of its incubation programme and seeks out and builds valuable partnerships for the members of the Group.

In 2017, two partnerships were established: FintechBlocks developed the Bank's new innovation platform and FaceKom developed the unique video-bank-assisted account opening.

Each year MKB Fintechlab selects 6-10 Hungarian and regional start-up companies that are developing global standard fintech solutions and provides a unique incubation environment (accelerated development path and validation, product development and entry into the market) and financial support for them. In 2017, six Hungarian fintech start-ups took part in the incubation programme, and some of them won renowned Hungarian and international awards.

In 2017 MKB Fintechlab also began to raise its activities to international level: start-ups from 11 countries applied for the second incubation programme.

## MKB SZÉP CARD

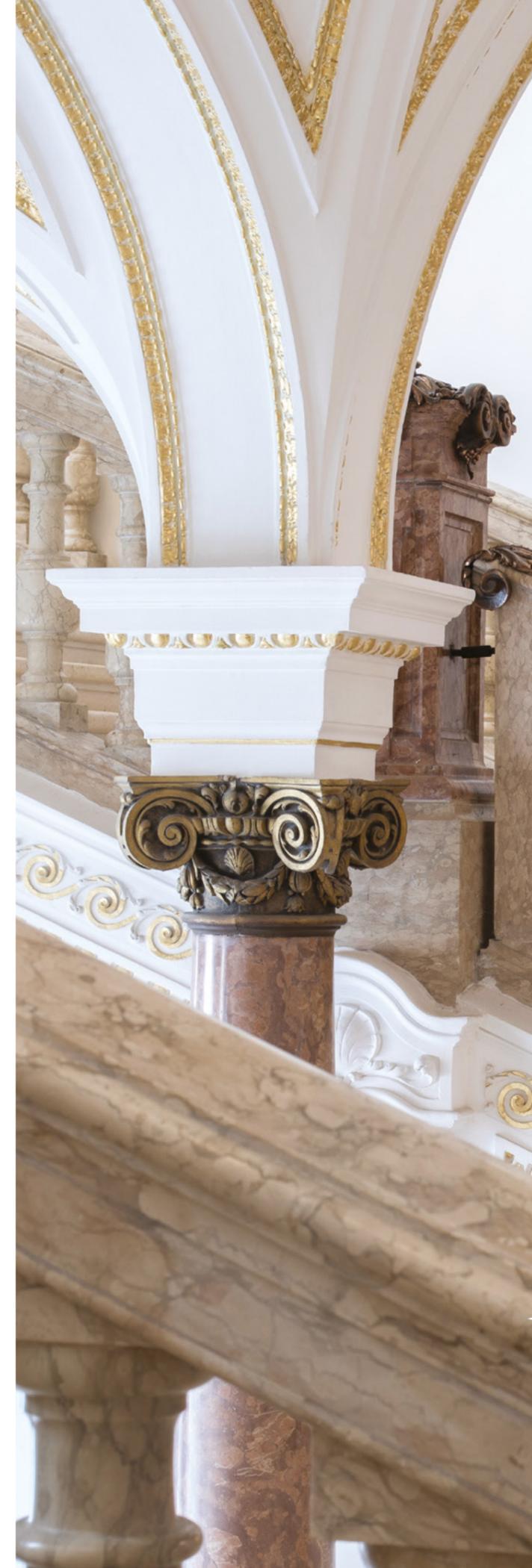
The popularity of MKB SZÉP Cards speaks for itself. It rapidly became one of the most frequently selected extra-wage benefits. It allows for advanced, versatile and comfortable utilization for SZÉP Card holders at more than 23 thousand MKB acceptance sites in Hungary.

By the end of 2017, in total 216 thousand employees benefitted from the options available with the MKB SZÉP Cards to enjoy recreation and relaxation offered in the form of preferentially taxed employer benefits, which translated into 16% increase in the number of users of MKB SZÉP Cards.

In 2017, cardholders received almost 13% more benefits, which corresponds to HUF 15.3 billion. The consumption ratio is an excellent indicator of the efficiency of the Card, hence HUF 14.2 billion of the granted amounts was turned back into the Hungarian economy over one year.

## MKB-PANNÓNIA FUND MANAGER

In 2017 a new phase opened in the history of the MKB Group with the merger of the asset and fund management companies that had previously operated as separate business associations: MKB Investment Fund Manager, MKB Bank's Portfolio and asset management division and Pannónia CIG Fund Manager were incorporated into one entity. As a result of the transaction, the combined portfolio and fund management company (in terms of assets), became one of the five largest players in the Hungarian market. The objective is to develop the most effective professional cooperation between the MKB Group and the recently founded MKB-Pannónia Fund Manager.



## STRATEGIC COOPERATIONS

### MKB PENSION FUND

By the end of 2017, the voluntary segment of MKB Pension Fund had more than 84 thousand members and held almost HUF 133 billion assets which corresponds to almost 10% of the market share and ranked as the 5th largest pension fund. The portfolio grew significantly, by almost 4.5% year on year. The terms and conditions offered by the Fund are among the most favourable available of the leading funds; its 22-year history, stable and prudent operation, professional background and results provide a guarantee for the savings of its members for retirement. The spectacular 14% increase in individual member contributions was an outstanding result in 2017, clearly reflecting the increasing and deliberate intention of the members to save more for their retirement.

The private pension pillar of MKB Pension Fund had approximately 4 thousand members and HUF 19.5 billion assets in 2017. The main objective of the Fund is to offer services that fully satisfy customer needs with new innovative solutions. The Fund is committed to the continuous development of online services and therefore made electronic administration for its customers and employers available in 2017. With the Personal hosting and Electronic administration service, members can view their data stored in the system simply and rapidly, monitor the increase in savings and the annual account history, as well as check their current portfolio. As an electronic administration interface, the Employer portal offers administration advantages to employer partners.

### MKB-PANNÓNIA HEALTH AND MUTUAL FUND

MKB-Pannónia Health and Mutual Fund, working with the best operational infrastructure, has been consistently one of the leading and largest funds for twenty years. The Health and Mutual Fund operates via an advanced online administration system offering a broad array of services. At the end of 2017, it had more than 186 thousand members and its assets under management reached HUF 12.3 billion.

Following a successful tender, Dimenzió Voluntary Health and Mutual Fund merged with MKB-Pannónia Health and Mutual Fund on 1 January 2018, which strengthened its market presence and allowed the fund to become the 2nd largest player in regards to members among the health funds in the Hungarian market, with the largest assets and with a 210 thousand-strong membership.

In 2017, individual contributions grew by a remarkable 27% and in 2017, for the first time ever they were higher than the employer contributions.

Members are able to spend their savings on themselves and on their family members at approximately 15 thousand service providers across the country, out of which 8,700 also accept MKB Health Fund cards. Customer satisfaction of the fund members illustrates well the success of the self-assistance services, which have undergone dynamic growth since their introduction in 2016.

The primary objective of the fund is to enhance customer satisfaction thus placing a strong emphasis on introducing new services within the legal framework. As a novelty, on 1 April 2017 it made the 'Care Health Insurance' available to all members on a solidarity basis, through which the fund members became automatically insured and gained eligibility for a wide range of high-quality health services.

## HUMAN RESOURCES

In order to ensure the retention and motivation of its highly qualified staff and the replacement of its high quality workforce, MKB Bank had to respond to the increasing challenges generated by the tightening labour market in 2017, too.

At MKB Bank, the year 2017 was dedicated to the renewal of the human resource system and processes. The performance evaluation system was modernised in order to support effectively the achievement of business goals and to provide a solid basis for the sub-systems, such as remuneration, talent management and development.

An advanced and competitive value offer was designed for the staff, promoting efficient

work performance, individual development and physical and mental recreation. MKB developed an Employee Recognition Scheme to recognise the performance of colleagues who make outstanding contributions to the implementation of the strategy and show examples through their performance, professional knowledge and customer-centred approach.

The banking training and development programmes are re-organised in the complex internal organisation development system of the MKB Academy, where employees continuously develop both their professional knowledge and personal skills, which thus contribute to improve their individual effectiveness.

Amidst all those endeavours, particular attention is paid to health preservation: the extremely successful 'Health Programme' implements different actions each month to assist in charging the batteries for everyday work, including screening, office massages, ergonomics and posture counselling, innovative dietetics and relaxation programmes.

Through the divisions run by the MKB Sporting Association retooled in 2016, a wide range of sports activities can be accessed by the employees.

Our corporate culture is based on cooperation; we value each other and believe in the power inherent in it.



## CORPORATE SOCIAL RESPONSIBILITY

In its business operation, MKB applies the highest expectations and standards, from lending and investments, through environmental protection, to corporate social responsibility. MKB has set the goal of creating long-term social values with its operation for its direct environment. The Bank achieved undisputable results in that field in the past and intends to continue making efforts in that field in the future too.

MKB Group signed a cooperation agreement with the Hungarian Association of Agricultural Equipment and Machinery Distributors (MEGFO-SZ) in March 2017. The organisation has been focusing on strengthening the competitiveness of agriculture and the food production sector for many years, within the framework of which it launched its career orientation campaign under the title 'Join the agricultural machine operators' group!' The campaign calls attention to the opportunities inherent in agricultural jobs through

its main message, that states that agricultural engineering can provide a long-term living and is also suitable for establishing an independent business, which may even develop into a long-term enterprise across generations. In addition to the supply of banking services, the support of the young people operating in the agricultural sector in regard to their career orientation is also extremely important to the MKB Group. We consider the 'Join the agricultural machine operators' group!' programme as one of our key social responsibility elements. Within the framework of the 'Career Selection Days', organised in the autumn of 2017, we managed to address more than 5,000 students at 27 sites.

In cooperation with the International Children's Safety Service (ICSS), since 1997, MKB Bank has been running a scholarship scheme to assist talented children and young people living in difficult financial conditions in their studies. In each

academic year, one hundred children and young people with outstanding abilities but in socially disadvantaged positions are able to benefit from this initiative. Every fourth beneficiary is now a student in a higher education institution. Two students graduated in 2017, one of them obtained a diploma at Liszt Ferenc University of Music, and the other beneficiary completed studies at KOTK School of Foreign Economy. Both had received a scholarship in 2006. They were the last two to join the MKB scholarship Alumni Students Club, which now consists of twenty-six members including economists, engineers, doctors, archaeologists, IT experts and dance artists. In addition to the scholarship programme, which is the main pillar in the Bank's social corporate responsibility activities and with the help of which the first supported student received a diploma in 2007, the Christmas Children's Gala is also part of the annual cooperation of the Bank and ICSS.

In December 2017, MKB Bank joined the traditional advent donation collection programme of the Hungarian Interchurch Aid,

in an extraordinary manner, in cooperation with gastro-blogger Dóra Havasi and You-tuber "Barni" Barna Abosi. MKB Bank raised the donations offered by the donors to the Hungarian Interchurch Aid by ten times, so Chief Executive Officer, Dr. Ádám Balog was able to hand over HUF 2.3 million to the organisation. Tradition, innovation, cooperation: this extraordinary donation collection programme was launched in the spirit of those values. Tradition is a donation in itself, the innovation is the use of bloggers and social media for such purposes and the cooperation is the joint effort of a Hungarian-owned bank, a Hungarian non-governmental organisation and talented Hungarian young people.

Support of sports and health preservation is one of the pillars of the Bank's social corporate responsibility policy which contributed to the organisation of one of the most successful aquatic World Championships of all times, in Hungary.



## AWARDS AND RECOGNITION

### **BANKMONITOR.HU, 2017: MKB GAINED THE 'BEST HOME LOAN' AND THE 'BEST PERSONAL LOAN' AWARDS**

The Rate Adjusted HUF Home Loan and the Mosoly (Smile) Personal Loan of MKB Bank proved to be the best in their respective categories among more than 4,000 financial products of more than 40 banks and financial service providers in the ranking of Bankmonitor 2017.

### **MKB FUND MANAGER RECEIVED THREE PROFESSIONAL AWARDS AT THE AWARD CEREMONY OF PRIVÁTBANKÁR.HU KLASSZIS 2017**

Based on objective indicators, the economic portal elected the fund managers and investment funds of the year in 2017, too. In the latter competition, the funds of MKB Investment Fund Manager won in the categories of 'Best Mixed Balanced Fund of the Year', 'Best Advanced Market Equity Fund of the Year' and 'Best Closed-end Capital Protected Fund of the Year'.

### **MASTERCARD - BANK OF THE YEAR 2017: MKB WAS REWARDED IN THREE CATEGORIES**

MKB was among the top three spots in three categories in one of the most reputable competitions of the Hungarian banking sector, the 'Mastercard - Bank of the Year' contest held for the twelfth time in 2017. The independent professional jury invited by Mastercard evaluated 63 professional entries where MKB Bank was awarded the impressive third place in the

categories of 'Most innovative bank of the year', 'Savings product of the year' and 'Retail and online banking instrument of the year'.

### **MKB RECEIVED ITBUSINESS, 'DIGITAL COMPANY OF THE FUTURE' AWARD**

The infocommunications business journal grants this award to companies leading in digital development. According to their argument, the award was granted considering the fact that MKB was the first in the region to replace its IT infrastructure and account management system, which is a major IT development project even on an international scale. In addition, the FinTech Academy and competition were also highlighted, as well as the incubation programme of MKB.

### **ÁDÁM BALOG RECEIVED THE AWARD OF CEO OF THE YEAR AT THE 32ND CEO MEETING**

The 'CEO of the Year' award in the banking sector was granted to the CEO of MKB Bank, Dr. Ádám Balog.

### **ITBUSINESS: MÁRK HETÉNYI WAS RANKED AS THE 7TH MOST SUCCESS- FUL AMONG THE TOP 25 ICT MANAGERS**

The IT-Business information technology weekly magazine prepared its list of top managers for 2017: Márk Hetényi, who is in charge of the IT development at MKB Bank, being the only bank IT manager on the list, was ranked as the 7th most successful among the TOP 25 ICT managers.

## THE MANAGEMENT BOARDS OF MKB BANK

31 December 2017.

### **BOARD OF DIRECTORS**

<b>CHAIRMAN</b>	János Jaksa
<b>MEMBERS</b>	Dr Ádám Balog Balázs Benczédi Dr András Csapó Márk Hetényi Imre Kardos Rakesh Kumar Aggarwal

### **SUPERVISORY BOARD**

<b>CHAIRMAN</b>	Dr Mihály Barcza
<b>MEMBERS</b>	Albert Godena Tibor Lados Dr Ádám Lovászi-Tóth Ferenc Müller János Nyemcsok

### **EXECUTIVE COMMITTEE**

<b>CHAIRMAN</b>	Dr Ádám Balog
<b>MEMBERS</b>	András Bakonyi Zoltán Bánfi Dr András Csapó Csaba Fenyvesi Ildikó Ginzer Márk Hetényi János Nyemcsok

## ANNEX: MKB GROUP'S FINANCIAL INDICATORS

Data in HUF million, unless indicated otherwise

# STATEMENT OF FINANCIAL POSITION OF MKB GROUP

ASSETS	2016	2017
Cash reserves	97,914	31,599
Loans and advances to banks	67,039	78,017
Financial assets measured at FVTPL	75,210	72,319
Investments in securities	924,137	902,712
Loans and advances to customers	858,072	858,592
Non-current assets held for sale and discontinued operations	309	21,648
Other assets	28,081	27,469
Deferred tax assets	3,320	3,312
Investments in jointly controlled entities and associates	1,651	2,643
Intangibles, property and equipment	45,883	46,676
<b>TOTAL ASSETS</b>	<b>2,101,616</b>	<b>2,044,987</b>

LIABILITIES	2016	2017
Amounts due to other banks	376,262	239,312
Deposits and current accounts	1,519,868	1,539,140
Financial liabilities measured at FVTPL	29,983	43,366
Other liabilities and provisions	37,197	49,853
Deferred tax liabilities	6	5
Issued debt securities	12,892	10,624
Subordinated debt		22,307
<b>TOTAL LIABILITIES</b>	<b>1,976,208</b>	<b>1,904,607</b>
EQUITY	2016	2017
Share capital	100,000	100,000
Treasury Shares	(5,550)	(5,550)
Reserves	25,368	40,381
<b>TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK</b>	<b>119,818</b>	<b>134,831</b>
Non-controlling interests	5,590	5,549
<b>TOTAL EQUITY</b>	<b>125,408</b>	<b>140,380</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>2,101,616</b>	<b>2,044,987</b>

## STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME OF MKB GROUP

	2016	2017
Interest income	62,476	56,245
Interest expense	23,804	16,665
<b>NET INTEREST INCOME</b>	<b>38,672</b>	<b>39,580</b>
Net income from commissions and fees	28,664	28,846
Other operating expense, net	(6,286)	10,219
Impairments and provisions for losses	15,236	9,611
Operating expenses	38,283	48,685
Share of jointly controlled and associated companies' profit	273	389
<b>PROFIT / (LOSS) BEFORE TAXATION</b>	<b>7,804</b>	<b>20,738</b>
Income tax expense / (credit)	(1,692)	1,537
<b>PROFIT / (LOSS) FOR THE YEAR</b>	<b>9,496</b>	<b>19,201</b>

## CAPITAL ADEQUACY RATIO OF MKB GROUP

	2016 Basel III IFRS	2017 Basel III IFRS
Share capital	100,000	100,000
Outstanding share capital	100,000	100,000
Reserves	21,899	37,124
Intangible assets	(8,446)	(12,567)
AVA - additional valuation adjustments	(689)	(464)
<b>ADDITIONAL TIER 1</b>	<b>-</b>	<b>-</b>
<b>TIER 1: NET CORE CAPITAL</b>	<b>112,764</b>	<b>124,093</b>
Subordinated debt	-	22,307
<b>TIER 2: SUPPLEMENTARY CAPITAL</b>	<b>-</b>	<b>22,307</b>
<b>REGULATORY CAPITAL</b>	<b>112,764</b>	<b>146,400</b>
Risk-weighted assets (RWA)	758,269	750,832
Large loan limit	-	-
Operational risk (OR)	165,167	173,370
Market risk positions (MR)	13,368	6,549
<b>TOTAL RISK WEIGHTED ASSETS</b>	<b>936,804</b>	<b>930,751</b>
Regulatory capital / Total assets	5.37%	7.16%
Tier1 ratio	12.04%	13.33%
<b>CAPITAL ADEQUACY RATIO</b>	<b>12.04%</b>	<b>15.73%</b>

