



# ANNUAL REPORT

2016

Československá obchodní banka, a. s.



<b>Business name</b>	<b>Československá obchodní banka, a. s.</b>
Registered office	Radlická 333/150, Praha 5, Postal Code 150 57, Czech Republic
Legal status	Joint-stock company
Registration	Registered in the Commercial Registry of the City Court in Prague, Section B XXXVI, Entry 46
Date of registration	21 December 1964
Business activities	Bank
ID No.	00001350
Tax registr. No.	CZ699000761 (for VAT) CZ00001350 (for other taxes)
Bank code	0300
SWIFT	CEKOCZPP
Data box	8qvdk3s
Telephone	+420 224 111 111
Internet address	<a href="https://www.csob.cz">https://www.csob.cz</a>
E-mail	<a href="mailto:info@csob.cz">info@csob.cz</a>
Supervisory body	Czech National Bank (CNB) Na Příkopě 28, Praha 1, Postal Code 115 03, Czech Republic

Year-on-year percentage changes are computed on a mathematical basis from non-rounded figures.

## KEY FIGURES

Consolidated, EU IFRS

2016

2015

2014

### Financial Statements Figures

#### Balance sheet at the year end (CZK<sub>m</sub>)

Total assets	1,085,527	956,325	865,639
Loans and receivables	783,223	579,448	506,635
Deposits received from other than credit institutions	676,162	621,927	599,143
Debt securities in issue	222,997	166,492	27,928
Shareholders' equity <sup>1)</sup>	88,549	90,541	85,372

#### Statement of income (CZK<sub>m</sub>)

Operating income	34,043	32,542	31,443
– of which Net interest income	22,235	22,303	22,872
– of which Net fee and commission income	6,218	6,391	5,979
Operating expenses	15,651	15,687	14,981
Impairment of loans and receivables (incl. provisions)	617	983	927
Profit before tax	18,380	16,461	16,178
Profit for the year <sup>1)</sup>	15,141	14,010	13,604

### Ratios (%)

Return on average equity (ROAE) <sup>2)</sup>	17.3	16.4	16.4
Return on average assets (ROAA) <sup>2)</sup>	1.42	1.49	1.40
Cost / income ratio <sup>2)</sup>	46.0	48.2	47.6
Capital adequacy ratio <sup>3)</sup>	18.5	19.4	17.5
Leverage ratio <sup>4)</sup>	5.18	5.25	5.15
Net stable funding ratio <sup>4)</sup>	150.9	134.9	135.9
Loan-to-deposit ratio <sup>2)</sup>	79.3	79.9	76.4
Return on assets	1.39	1.47	1.57

### General Information (as at 31 December 2016)

Number of employees – the ČSOB group <sup>5)</sup>	8,232	8,203	7,406
Number of clients – the Bank (in millions) <sup>6)</sup>	2,803	2,831	2,855
Number of branches – the Bank <sup>7)</sup>	287	316	319
Number of ATMs	1,066	1,062	1,047

### ČSOB's Credit Rating<sup>8)</sup> (as at 31 December 2016)

Rating Agency	Long-term Rating	Outlook	Short-term Rating	Long-term Rating valid since
Moody's	A2	stable	P-1	20 June 2012
Standard & Poor's	A	stable	A-1	1 October 2014

1) Attributable to equity holders of the Bank.

2) As at the year end; for definition please refer to page 26.

3) According to CRR rules as at the year end. End of period regulatory capital (ratios) does reflect retained earnings.

4) According to CRR rules; for definition please refer to page 26.

5) Full-time equivalent employees; figures for 2015 and 2016 include ICT employees which were transferred from KBC Group bank to ČSOB as of 31 December 2015.

6) Due to methodological change 2014 figure was restated.

7) Includes ČSOB branches and Era financial centers, i.e. without approximately 3,000 post offices.

8) Credit ratings as of the date of this Annual Report are part of the Report of the Board of Directors.

## OPENING STATEMENT



### Ladies and gentlemen, dear colleagues,

Last year was an exciting year for the mortgage market. The increase in demand for housing finance through this product has been enormous, and this was intensely felt in ČSOB too. Record low interest rates further supported this surge. Clients were also very interested in, and tending towards, consolidation loans. I am glad that, at the background of these trends, the banking sector in the Czech Republic remains generally stable and profitable. This also contributes to ČSOB's ability to develop all of its products and services.

Bank-insurance in ČSOB also grew strongly and has further differentiated us from the competition and which we utilize to meet our clients' needs. Last year we also met our clients' needs through a host of new applications and technologies. In many cases, we were in the position of pioneers, as, for example, in the case of the mobile wallet NaNákupy. Furthermore, we also improved the iPad app Financial Markets, and we offered our clients a simple and cheap solution for Electronic Records of Sales.

We are pleased that we managed to combine care for clients in its digital form with traditional communication at our branch offices. We want people to experience a high-quality of service and to leave with a feeling that they have spent their time effectively in a pleasant environment. The recent reconstruction of more than thirty of our branches should bolster these efforts and further improve the environs not only for customers, but also for our employees. For example, we newly offer a more transparent division of our branches into three zones, and we are planning further improvements of their interiors.

In the past year we have also developed our cooperation with Czech Post. At Postal Savings Bank branches we offer our clients the Post Loan, the most affordable product of its kind on the market, whose launch was accompanied by a very successful campaign hailed by experts. I must also thank everyone who contributed to the Czech Post tendering process. Because of the tender, we can now discuss the possibility of a contract, which would enable us to offer not only Postal Savings Bank services but also our insurance products at post offices from 2018.

I cannot enumerate here the whole range of our successful achievements in 2016, but I would still like to highlight the growing popularity of refinancing and consolidation loans. Especially younger clients, who increasingly find their way to us through new technologies, appreciate the options of biometric signature, payment by mobile phone, or mobile phone-based ATM withdrawals. Our supplementary pensions for children and innovative safety features in electronic banking are also noteworthy. ČSOB also scored in various competitions. For example, we were named the best private bank, the most successful Mastercard Partner of 2016, and our Cool karta earned us the Innovator of the Year award.

Our results in our approach to social responsibility and sustainability please us equally. Our CSR strategy rests on solid foundations. In term of philanthropy we focus on ČSOB Education Programme, and also a successful project, ČSOB Helps the Regions. In the following year we want to further focus on our staff, because they are our principal asset and to promote, for example, their active involvement in initiatives aimed at financial literacy of children and adults.

In the field of information technology, I have no doubt, we will continue to lead as one of the major innovators as demanded by both the market and our clients. We also see more opportunities for the development of a unique model of bancassurance, and thanks to innovation and simplification we are the reference point in the Czech market for client experience.

2017 will therefore be surely a year full of challenges. We were not idle, however, and already at the end of 2016, we expanded our management team. Also thanks to this reinforcement I believe in another successful year that will positively mirror in the history of ČSOB Group.



**John Arthur Hollows**

Chairman of the Board of Directors

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# CZECH ECONOMY

## General Economic and Market Indicators

**The ČSOB group's business is conducted in the Czech Republic and is, therefore, influenced by prevailing macroeconomic trends in the country.**

The Czech economy went through a cyclical slowdown in 2016, with growth slightly exceeding the limit of two per cent mainly due to the slowdown in investments from the public sector. And so the effect of drawing the available money from EU funds, which stimulated investments and the short term boom in construction in 2015, faded away. Economic growth in 2016 was mainly due to household consumption helped by record employment and the accelerating pace of nominal and real wages growth, which led not only to record high consumer confidence but also historically the highest retail sales and household housing investments.

The supply side of the economy remained under the influence of the manufacturing industry in 2016, which was dominated by the production of passenger cars. Passenger car production reached a new peak, which is reflected not only in the actual results of the industry but also in a higher trade surplus for the country. Services also contributed to the economy, especially transport, trade and real estate market activities, which experienced a boom due to rising demand from households for new flats and houses, helped not only by a strong sentiment, but also low mortgage interest rates. Because of the delayed availability of new properties property prices saw a further acceleration of growth.

The Czech economy had already begun to show significant inflationary pressures in 2016. In December, the annual inflation reached the CNB target (2%) because of faster growth in the prices of food, fuel, housing costs and the effect of the introduction of Electronic Sales Records. After a while the economy gradually began to show signs of demand-pull inflation.

During the year the CNB kept the exchange system, introduced in November 2013, unchanged but because of growing interest mainly from foreign investors the CNB had to extensively intervene on the forex market. The result was not only an increase in crown liquidity in the financial sector to just under 1.4 trillion crowns and an increase in foreign exchange reserves to 81 billion euros but even negative yields on government bonds, in which foreign investors started to invest their new crowns. Their activity on the bond market reached new highs, and the share of government bonds owned by non-residents surpassed the 30% threshold for the first time.

The availability of credit in the economy in 2016 rose further, not only due to its high liquidity and low interest rates and negative bond yields but also because of further growth in the quality of banks' loan portfolios. Given that the propensity of consumers did not change much savings deposits also grew dynamically as well alternative forms of investment in Czech households.

Public sector management in 2016 ended in a slight surplus. The Czech Republic managed to reduce its relative debt even more - to below 40% of GDP and thus it remains one of the least indebted EU countries.

The following table sets out key Czech macroeconomic indicators for the periods indicated.

Indicator <sup>1)</sup>	Measurement Unit	2016	2015	2014	2013	2012
Nominal GDP	CZKbn	4,715	4,555	4,314	4,098	4,060
Real GDP growth	% change, Y / Y	2.3	4.6	2.7	(0.5)	(0.7)
Real GDP per capita	CZKths	414.4	405.5	388.5	378.8	380.7
Real GDP growth per capita	% change, Y / Y	2.2	4.4	2.6	(0.5)	(0.9)
Inflation rate (CPI)	%, year end	2.0	0.1	0.1	1.4	2.4
Unemployment rate	%, average	4.0	5.1	6.2	7.0	7.0
General government budget balance / Nominal GDP	%	0.6	(0.6)	(1.9)	(1.2)	(3.9)
General government debt	CZKbn	1,755	1,836	1,819	1,840	1,805
General government debt / Nominal GDP	%	37.2	40.3	42.2	44.9	44.5
Exports of goods and services <sup>2)</sup>	% change, Y / Y	2.0	4.3	13.0	1.7	7.6
Imports of goods and services <sup>2)</sup>	% change, Y / Y	(0.4)	5.0	12.8	0.6	6.4
Trade balance / Nominal GDP <sup>2)</sup>	%	5.3	4.1	5.1	4.1	3.0
Interest rate (three month PRIBOR) <sup>2)</sup>	%, average	0.3	0.3	0.4	0.5	1.0
CZK / EUR exchange rate <sup>2)</sup>	average	27.0	27.3	27.5	26.0	25.1

Source:

1) CZSO, unless stated otherwise.

2) CNB.



# REPORT OF THE BOARD OF DIRECTORS

## Highlights and Main Events

The terms used in this section are defined and further discussed below.

The Year 2016 for ČSOB: bringing innovations into clients' everyday lives. Growth in business volumes and excellent loan quality.

### Key Figures of the ČSOB Group in 2016

- In 2016, the ČSOB group's **net profit** attributable to the owners of the parent (EU IFRS) increased by 8% year on year to **CZK 15.1 bn**.
- **Loan portfolio** (including ČMSS) increased to **CZK 618 bn** (+6% year on year), thanks mainly to mortgages and consumer finance.
- **Group deposits** (including ČMSS) grew to **CZK 752 bn** (+7% year on year).
- The total volume of **assets under management** reached **CZK 191 bn** (+4% year on year).
- **Operating income** increased to **CZK 34.0 bn** (+5% year on year).
- **Operating expenses** reached **CZK 15.7 bn** (flat year on year).

The ČSOB group closely manages credit risk and maintains strong capital and liquidity positions as reflected in the following 2016 year-end figures:

- **Credit cost ratio** decreased year on year to **11 bps** (Ytd. annualized) thanks to excellent loan quality.
- The **loan to deposit ratio** decreased year on year to **79.3%** and **Net stable funding ratio** (NSFR) increased year on year to **150.9%**.
- **Tier 1 ratio** (Basel III) stood at **18.2%**.

### Merger of Visa Inc. and Visa Europe Ltd.

As at 31 December 2015, the Group reported a share in Visa Europe. In June 2016, the takeover of Visa Europe Ltd. by Visa Inc. took place. The sales price is to be settled in three tranches: cash payment, transfer of preferred shares of Visa Inc. and further cash payment in 2019. As a result of the transaction, the Group recognised a gain of CZK 1,295 m reported in the consolidated statement of income for 2016 as a Net realised gain on available-for-sale financial assets.

For more details please refer to the Separate Financial Statements for the year 2016 (Note 16) and to the Consolidated Financial Statements for the year 2016 (Note 17).

### Dividends paid

Based on a sole shareholder decision from 22 April 2016, share of profit (dividend) of CZK 50.49 per share was paid for 2015, representing a total dividend of CZK 14.8 bn.

For more details please refer to the Separate Financial Statements for the year 2016 (Note 13) and to the Consolidated Financial Statements for the year 2016 (Note 14).

### Insourcing ICT

With effect from 31 December 2015, ICT (selected activities and processes, including a number of employees, assets and liabilities related to the ICT function) were reintegrated from KBC Group Czech Branch back to ČSOB. There is no change in the scope of ICT services provided to the ČSOB group. ICT insourcing assumes mainly a lower administrative burden and higher flexibility in solving the requests of internal clients.

For more details please refer to the Separate Financial Statements for the year 2016 (Note 18) and to the Consolidated Financial Statements for the year 2016 (Note 3).

## Changes in ČSOB's Managing and Supervisory Bodies

- Pavel Kavánek ended his term in office as a member of ČSOB's Audit Committee with effect from 27 January 2016.
- Ladislav Mejzlík was appointed as a member of ČSOB's Audit Committee with effect from 27 January 2016.
- Hendrik George Adolphe Gerard Soete ended his term in office (after 4 years) as member of the Supervisory Board of ČSOB with effect from 20 June 2016.
- Martin Jarolím ended his term in office as a member of ČSOB's Supervisory Board and as a member of ČSOB's Audit Committee with effect from 30 June 2016.
- Willem Hueting was elected a member of ČSOB's Supervisory Board and as a member of ČSOB's Audit Committee with effect from 1 July 2016.
- Marc Wittemans was elected a member of ČSOB's Supervisory Board with effect from 1 October 2016.

*For personnel changes in detail of ČSOB's Managing and Supervisory Bodies please refer to the Corporate Governance section of this Annual Report.*

## Innovation Leadership in 2016

### ČSOB launched many innovations ensuring client comfort and flexibility.

- Clients enjoy payments in stores without their wallet thanks ČSOB's mobile wallet **ČSOB NaNákupy**, which introduced NFC payment as the first on the Czech market, unique service supporting both Visa and Mastercard. The service, named as the innovation of the year in the Czech Republic by Visa and Mastercard, has triggered positive reactions of the public, strengthening the innovative image of the bank. It's a universal tool for shopping – in 2017, it will include e-commerce payment, smart card management, loyalty cards virtualization, shared shopping lists and a universal receipt storage.
- ČSOB brought modern and hassle free services for clients to all branches thanks to **paperless operations**, allowing most documents to be signed digitally and saved in Internet Banking. The number of contracts signed with biometric technology has been increasing throughout 2016 and at the same time 93% of clients reported being satisfied with the service.
- **Redesigned branches** provide new concept of client services in a pleasant environment with timeless design and modern technologies.
- Cash withdrawals are more comfortable and secure with **80 contactless ATMs** launched in 2016.
- Clients can manage and monitor their investment products from smartphone, tablet or desktop in a one-stop shop digital environment – new investment portal **ČSOB Investice**.
- 140 dedicated **insurance advisors** at the bank branches provide face-to-face advisory for clients to insure their risks.
- **ČSOB Premium** brings individual care, such as a Personal Assistant, who can arrange various requests be it booking concert tickets or fix a meeting with the service man to name few, as well as advantageous products and services for affluent clients. By the end of the year 2016, more than 22,000 clients joined ČSOB Premium.
- **Online payments** within ČSOB 7 days a week from early morning till late evening.
- ČSOB Pojišťovna launched for the Czech market unique **Insurance against phishing**. Now clients can be protected against web shop deception, electronic payment means fraud or virtual identity abuse.

## Awards

On the competitive Czech banking market, the quality of ČSOB's products and services was acknowledged by various international and local awards.

- ČSOB was named the **Best bank of 2016 in the Czech Republic** by international magazine **Global Finance**.
- **Visa** and **Mastercard** recognized ČSOB as the **Best Innovator in 2016** and winner of **Issuing Innovation 2016** in the Czech Republic respectively thanks to mobile wallet ČSOB NaNákupy.
- Czech business daily **Hospodářské noviny** appreciated ČSOB as the **Bank Innovator** with the product COOL karta.
- ČSOB Private Banking was awarded the **Best Private Bank in the Czech Republic for 2016** in a survey conducted by prestigious **Euromoney** magazine and by **The Banker / Private Wealth Management**.

## Other Awards

- Sodexo **Employer of the year for 2016** selected ČSOB the best employer in the capital city Prague and the second Best Employer above 5,000 employees in the Czech Republic.
- In the TOP Responsible Company 2016 award, ČSOB won Silver certificate for **TOP Responsible Large Company**, Bronze certificate for **Community Project for Public Benefit** and Bronze certificate for **Responsible Reporting**.
- ČSOB became the most successful partner of Mastercard in 2016 and received four awards - **the Issuer 2016, the Special Mention 2016: Issuer Commercial Product, the Acquiring Special Mention 2016** as well as the previously mentioned **Issuing Innovation 2016**.
- ČSOB won the title of the **acquisition finance Best bank** in the Czech Republic in 2016 awarded by ACQ Finance Magazine, claiming the prize for ninth time.
- Bratislava ring road project financed also by ČSOB awarded as **PPP Deal of the Year 2016 in Europe** by magazine Project Finance International.
- ČSOB Asset Management won in the competition the **European Structured Products & Derivatives** in the categories of the **Best Distributor** and the **Best Performance** in 2016 in the Czech Republic.
- In 2016, Finance advisory company Fincentrum named ČMSS the **Building Savings Bank of the Year** and Hypoteční banka took third place in the **Mortgage of the Year** with the product "Pěkná hypotéka".
- ČSOB Penzijní společnost received **Superbrands 2016** award for the year 2015, awarded by Brand Council expert committee.
- Patria was awarded by the magazine Corporate LiveWire as **the Best M&A Advisory Firm of the Year 2016** in the Czech Republic.

For a list of awards won by the ČSOB group, please go to [www.csob.cz](http://www.csob.cz).

## The Board of Directors' Assessment of 2016 and Expectations for 2017

The ČSOB group delivered a solid performance on stable Czech banking market, while pressure from low interest rate environment and regulations has not abated.

Czech banking market was characterized by higher activity in 2016, stemming from, among other, positive economic development and its expectations and monetary policy, which the Czech National Bank kept relaxed via low interest rates and exchange rate commitment.

The banking sector remained generally stable and profitable and its resilience was confirmed by results of stress tests conducted by the Czech National Bank. Banking sector was supported by recovery of the Czech economy. After an exceptionally successful year 2015, the GDP growth in 2016 halved, amid a slowdown in investments from the public sector. The GDP for 2016 was 2.3% higher than in the previous year. The economy was supported by consumption of households and foreign trade. Economic growth was accompanied by a further decline in unemployment. Czech banks continued to benefit from access to customer deposits and ample liquidity on the market, however margins remained under pressure in the low interest rate environment.

Czech banking landscape continued to be affected by the new legislations and changes of regulatory environment. First, previously introduced regulation of interchange fees for card-based payment transactions first fully manifested in 2016. At the beginning of 2016 a change in the bank taxes came into force - banks and other financial institutions newly contribute to two funds: Deposit Insurance Fund and Crisis Resolution Fund (or Single Resolution Mechanism). Further, the Czech National Bank tightened qualitative and quantitative recommendations for prudential mortgage lending. Finally, Act on Consumer Credit came into force in December 2016 and brought substantial changes to the provision of consumer and mortgage loans.

In 2016, the ČSOB group further expanded bank-insurance model and continued to bring simple, transparent and user-friendly solutions in order to meet clients' expectations towards financial services providers. ČSOB delivered solid performance in 2016. Net profit increased by 8%, partially thanks to the sale of stake in Visa Europe. Solid growth in business volumes, excellent loan quality and stable costs were offset by declining margin and lower fees. The loan portfolio expanded, driven by growth of mortgages and supported by accelerated consumer finance lending. The group deposits increased, driven by current accounts. Total assets under management increased as well. Despite the growth in business volumes ČSOB managed to keep excellent loan portfolio quality. The credit cost ratio decreased year on year, the non-performing loan ratio decreased as well and remains below 3%.

According to the ČSOB group's macroeconomic outlook, the GDP for the year 2017 is expected to grow by 2.3% year on year. The Board of Directors considers that moderate economic growth and low unemployment levels will keep credit demand strong, as well as support loan quality, even though partial normalization of low levels of credit costs is conceivable. ČSOB will continue to benefit from good access to customer deposits to fund lending.

The Bank Board of the Czech National Bank stated that koruna exchange rate commitment, which the Czech National Bank has been using to fulfil the inflation target since November 2013, will not discontinue before second quarter of 2017. The exit from the exchange rate commitment could be accompanied by increased volatility of the koruna exchange rate, as well as potential volatility on the market of government bonds.

In the coming year, the banks will continue to be challenged by regulatory pressure. Among other, additive countercyclical capital buffer (CCB) set at 0.5% for 2017 entered into the minimum capitalization required by the Czech National Bank. Recommendations of Czech National bank for prudential mortgage lending will further tighten from April 2017 and the impact of Act on Consumer Credit will fully manifest in 2017.

Servicing retail and SME clients continues to be core to the business of the ČSOB group also in 2017. In addition, the ČSOB group will aim to continue accommodating the needs of its corporate clients. The ČSOB group will further endeavor to maintain solid profitability via business volumes growth and efficient cost control while sticking to its focus on asset quality.

To cope with the challenges ahead, ČSOB will be focused primarily on servicing clients via more proactive offering of complete and relevant solutions to their life situations. ČSOB will continue to provide face-to-face services to clients who require it. ČSOB will continue to bring new products into the digital sphere. The aim of ČSOB is that clients should be able to interact with ČSOB by all possible means including branches, internet, mobile applications and telephone and all these means need to be interconnected. To achieve this, ČSOB group will continue working in the background on more effective operations and manage costs carefully.

## Strategy of the ČSOB Group and its Business Model

The ČSOB group aims to become the reference in banking and insurance through putting client in the centre and achieving sustainable growth, driven by the PEARL culture.

The ČSOB group is one of the three largest financial services groups in the Czech Republic and the market leader in mortgages, building savings, private banking and leasing. ČSOB group serves our clients through multiple brands and distribution channels. The ČSOB group operates a portfolio of businesses that have a different stage of maturity and market position.

The ČSOB group has the ambition to deliver strong and sustainable performance. To reach this goal, the management continuously evaluates strategic choices and manages the ČSOB group's business portfolio. Key resources (human capital, equity, liquidity and IT create capacity) are allocated to areas of the best fit with this ambition. The ČSOB group: (i) cultivates its market positions, driven by value creation and through-the-cycle portfolio view; (ii) makes structural changes in its business in terms of simplification, innovation and group integration; and (iii) builds capabilities which are critical for future success.

As a response to both external and internal challenges, and particularly trend of digitalization and commoditization of traditional banking and insurance products and services, the ČSOB group is transforming the business model to better serve the needs of clients and at the same time lift the core capabilities to sustain the position over long term. The goal is to build an environment integrating banking and insurance products and services that will delight clients with an extraordinary experience:

- Clients will be constantly in the centre of everything the ČSOB group does. They will be empowered to choose the services they need and like and ČSOB will be able to help to solve their life situations;
- Clients will be enabled to interact with the bank through seamlessly integrated omnichannel;
- In its environment, the ČSOB group will gradually integrate also services beyond the traditional banking and insurance services and products (such as client identity management or secured digital archive).

Corporate social responsibility is an integral part of ČSOB's corporate philosophy. The support is focused on four areas: longevity, environmental responsibility, entrepreneurship and financial literacy.

The PEARL culture is the foundation of the ČSOB group's business strategy. It is guided by five imperatives: Performance, Empowerment, Accountability, Responsiveness and Local embeddedness.

## Financial Results

All financial figures hereinafter were drawn from ČSOB's 2016 audited, consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU IFRS), unless otherwise stated.

### Financial Ratios

	2016 (%)	2015 (%)	Y/Y change (pp)
Return on average equity (ROAE)	17.3	16.4	0.9
Return on average assets (ROAA)	1.42	1.49	(0.07)
Net interest margin	2.93	3.01	(0.08)
Cost / income ratio	46.0	48.2	(2.2)
Credit cost ratio	0.11	0.18	(0.07)

	31. 12. 2016 (%)	31. 12. 2015 (%)	Y/Y change (pp)
Loan-to-deposit ratio	79.3	79.9	(0.6)
Capital adequacy ratio*	18.5	19.4	(0.9)
Leverage ratio*	5.18	5.25	(0.07)
Net stable funding ratio*	150.9	134.9	16.0

\* Calculation is based on CRR rules

Note: pp = percentage point.

For definitions and glossary of financial ratios please refer to the end of the Report of the Board of Directors.

## Consolidated Statement of Income

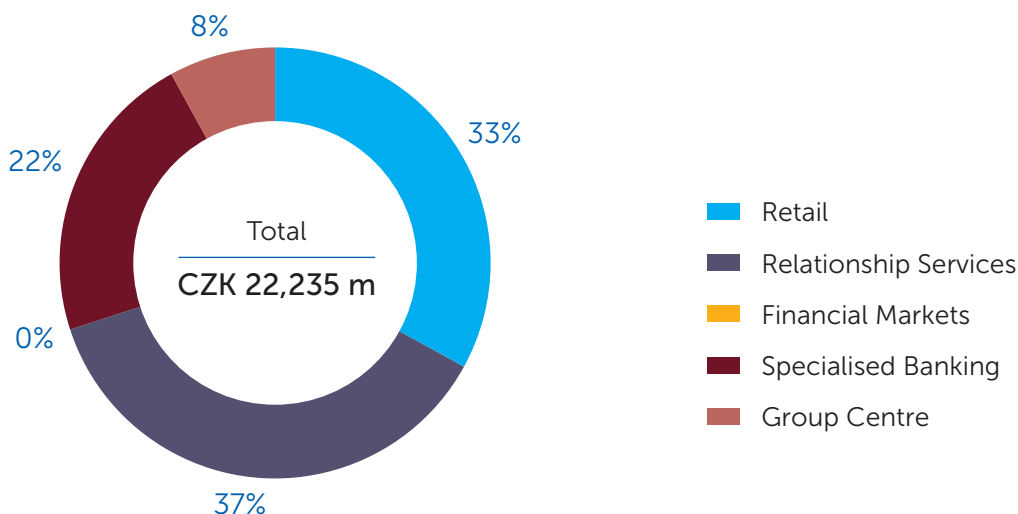
(CZKkm)	2016	2015	Y/Y change (%)
Interest income	25,043	25,580	(2.1)
Interest expense	(2,808)	(3,277)	(14.3)
<b>Net interest income</b>	<b>22,235</b>	<b>22,303</b>	<b>(0.3)</b>
Fee and commission income	9,577	9,827	(2.5)
Fee and commission expense	(3,359)	(3,436)	(2.2)
<b>Net fee and commission income</b>	<b>6,218</b>	<b>6,391</b>	<b>(2.7)</b>
Dividend income	8	8	0.0
Net gains from financial instruments at fair value through profit or loss	3,147	2,652	18.7
Net realised gains on available-for-sale financial assets	1,294	326	296.9
Other net income	1,141	862	32.4
<b>Operating income</b>	<b>34,043</b>	<b>32,542</b>	<b>4.6</b>
Staff expenses	(7,510)	(7,007)	7.2
General administrative expenses	(6,873)	(8,063)	(14.8)
Depreciation and amortization	(1,268)	(617)	105.5
<b>Operating expenses</b>	<b>(15,651)</b>	<b>(15,687)</b>	<b>(0.2)</b>
Impairment losses	(708)	(1,081)	(34.5)
<i>of which Impairment on loans and receivables (including provisions)</i>	(617)	(983)	(37.2)
Share of profit of associates	696	687	1.3
<b>Profit before tax</b>	<b>18,380</b>	<b>16,461</b>	<b>11.7</b>
Income tax expense	(3,232)	(2,472)	30.7
<b>Profit for the year</b>	<b>15,148</b>	<b>13,989</b>	<b>8.3</b>
Attributable to:			
Owners of the parent	15,141	14,010	8.1
Non-controlling interests	7	(21)	n/a

### Discussion of the Statement of Income Main Items

With a 65% share, the **net interest income** (NII) was the largest part of the operating income. The ČSOB group's NII remained almost stable year on year (-0.3%) as lower NII in Retail segment and Financial Markets was largely compensated by higher NII in Relationship Services and Specialised Banking. The **net interest margin** (NIM) dropped to 2.93% in 2016 from 3.01% in 2015, the decline was influenced by continuing lower reinvestment yields and pressure on lending margins (on mortgages and consumer finance). Ongoing growth in business volumes offsets the declining margin.



## Net interest income by reported segments



Out of the reporting segments, the highest contribution came from Relationship Services which represents 37% of consolidated NII; the NII in this segment increased by 2.1% year on year driven by growth in business volumes. The ČSOB Retail segment, making up 33% of the consolidated NII, decreased by 2.0% year on year due to declining margins. The NII of the ČSOB Specialised Banking segment, which represents 22% of consolidated NII, increased by 4.6% year on year.

The **net fee and commission income** (NFCI) represented 18% of operating income. In 2016, NFCI decreased by 2.7% year on year. The decrease was driven mainly by lower fees from payment services, collective investments and higher distribution fees.

**Net realised gains on available-for-sale financial assets** increased by more than 100% year on year fully driven by one-off gain from Visa Europe sale (CZK 1,295 m).

**Other net income** increased by 32% year on year thanks to revenues linked to ICT insourcing.

**Staff expenses** represented 48% of the ČSOB group's operating expenses in 2016. The largest part (71%) were wages and salaries which increased by 6.3% year on year mainly due to ICT insourcing (i.e. 750 employees were transferred from KBC Group back to the Bank). Adjusted for ICT insourcing impact, staff expenses would decrease year on year as a result of lower severance payments, higher base (restructuring reserve booked in 2015) and higher share of IT projects with capitalized staff expenses.

**General administrative expenses** (GAE) contributed 44% to the ČSOB group's operating expenses in 2016. GAE decreased by 14.8% year on year due to change in structure of operating expenses linked to ICT insourcing. Expenses related to the aforementioned ICT services are included under GAE fully in 2015, while in 2016, a portion of ICT related expenses is reported as a part of Staff expenses and Depreciation and amortization. Due to ICT insourcing, ICT related expenses showed a decrease of 33.9% year on year, nevertheless remained the largest part of GAE (33%). Other major items of GAE showed various development in 2016. Building-related expenses decreased (15% of GAE; -4.4% year on year). Banking taxes, including deposit insurance premium, Securities Traders Guarantee Fund and new contribution to the Crisis Resolution Fund (or the Single Resolution Mechanism) in effect from January 2016 decreased (11% of GAE; -19.3% year on year). Marketing expenses increased (9% of GAE; +12.6% year on year).



**Impairment losses** comprise losses in the asset portfolio arising from on-balance-sheet and off-balance-sheet transactions, taking into account the structure and quality of the asset portfolio and general economic factors. Total impairment losses decreased by 34.5% year on year as a result of a decline in impairments on loans and receivables (by 37.2%; including provisions) and impairments on other assets (by 7.1%).

As a result of the trends described above, the **net profit for 2016 attributable to owners of the parent equaled CZK 15,141 m**, i.e. 8.1% higher than the figure for 2015.

More details are available in the Consolidated Financial Statements for the year 2016: Net interest income (Notes 5 and 6), Net fee and commission income (Note 7), Other net income (Note 9), Staff expenses (Note 10), General administrative expenses (Note 11) and Impairment losses (Note 12).

## Consolidated Statement of Financial Position

(Condensed)

(CZKm)	2016	2015	Y/Y change (%)
Financial assets held for trading	20,008	29,494	(32.2)
Available-for-sale financial assets	56,938	59,961	(5.0)
Held-to-maturity investments	132,679	136,433	(2.8)
Financial assets designated at fair value through profit or loss	-	15	(100.0)
Loans and receivables	783,223	579,448	35.2
<b>Total assets</b>	<b>1,085,527</b>	<b>956,325</b>	<b>13.5</b>
Financial liabilities held for trading	40,044	29,970	33.6
Deposits at amortised cost received from other than credit institutions	676,162	621,927	8.7
<b>Total liabilities</b>	<b>996,792</b>	<b>865,606</b>	<b>15.2</b>
Total equity	88,735	90,719	(2.2)
<b>Total liabilities and equity</b>	<b>1,085,527</b>	<b>956,325</b>	<b>13.5</b>

### Discussion of the Statement of Financial Position Items

Total consolidated assets of ČSOB group increased by 13.5% year on year. Loans and receivables, the largest item thereof with 72% share, increased by 35.2% year on year (over 80% of the increase is due to reverse repo operations with Czech National Bank). Loans and receivables are discussed in detail in the Business Results section below.

The development of securities portfolios (19% of total assets in aggregate) in 2016:

- Financial assets held for trading (2% of total assets) declined by 32.2% year on year mainly due to decrease in bond portfolio.
- Held-to-maturity investments (HTM; 12% of total assets) went down by 2.8% year on year.
- Available-for-sale financial assets (AFS; 5% of total assets) decreased by 5.0% year on year.

Further discussion of the portfolios can be found in the Consolidated Financial Statements for the year 2016, including the breakdown of exposure per type of borrower (Notes 16 and 17) or per country (Note 40).

No treasury shares were held by the ČSOB group at 31 December 2016 and 2015.

## Regulatory Capital Adequacy

The primary objectives of ČSOB's capital management are to ensure that it complies with externally and internally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business and to maximize shareholder value.

The ČSOB group manages its capital structure in the light of changes in economic conditions and the risk characteristics of its activities.

### Consolidated Capitalization and Risk Weighted Assets of the ČSOB Group

(CZKmn, unless indicated otherwise)	2016	2015	Y/Y change (%)
CET1 capital before regulatory adjustments	78,404	76,546	2.4
Regulatory adjustments of CET1 capital	(9,423)	(9,510)	(0.9)
Tier 1 capital = Core Tier 1 capital	68,981	67,036	2.9
Tier 2 capital	1,311	1,102	19.0
<b>Total regulatory capital</b>	<b>70,292</b>	<b>68,138</b>	<b>3.2</b>
Risk weighted assets on credit and settlement risk	308,743	279,931	10.2
Risk weighted assets on market risk	14,072	15,248	(7.7)
Risk weighted assets on operational risk	56,156	56,539	(0.7)
<b>Total Risk weighted assets</b>	<b>378,970</b>	<b>351,718</b>	<b>7.7</b>
Tier 1 ratio = Core Tier 1 ratio (in %)	18.2	19.1	(0.9 pp)
Capital adequacy ratio (in %)	18.5	19.4	(0.9 pp)

Calculation is based on CRR rules.

Note: pp = percentage point.

End of period regulatory capital (and the respective ratios) reflects retained earnings. More details are available in the Consolidated Financial Statements for the year 2016 (Note 41).

## Credit Rating

Events related to ČSOB's credit ratings between 1 January 2016 and the date of this Annual Report.

In 2016, ČSOB was using the service of the following rating agencies:

- **Moody's Investors Service Ltd** ("Moody's") and
- **Standard and Poor's Rating Services** ("S&P").

Both rating agencies were registered according to the Regulation (EC) No. 1060/2009 on credit rating agencies. While choosing rating agencies, ČSOB proceeded according to the obligations laid down by the article 8d of the described regulation. The market share of each of the aforementioned rating agencies exceeds 10% on the European Union market.

In accordance with obligation set in the article 8d of the Regulation on credit rating agencies, ČSOB has considered appointing a rating agency with a market share below 10%. In the final decision, with regards to the position of ČSOB on the Czech market and the market know-how of the considered rating agencies, ČSOB has decided to use the services of the aforementioned rating agencies.

No debt securities issued by ČSOB had a credit rating assigned.

## Rating of ČSOB in 2016 and 2017

### S&P agency

- On 3 March 2016, S&P published a review of government support and Additional Loss-Absorbing Capacity and affirmed ČSOB long-term rating at A with a negative outlook.
- On 24 October 2016, S&P affirmed ČSOB's long-term rating at A and revised the outlook to stable from negative. The rating action followed stabilization of KBC Bank's outlook and affirmation of KBC Bank's rating.
- On 17 March 2017, S&P affirmed ČSOB's long-term rating at A with stable outlook. The rating action followed reclassification of Czech banking sector to BICRA (Banking Industry Country Risk Assessment) group 3 from group 4.

### Moody's agency

- At year-end 2016, the long-term rating assigned to ČSOB by Moody's was A2 with stable outlook.

## Business Results

### Main Factors Influencing the Financial and Business Results and the Market Position of the ČSOB Group

The ČSOB group's business results are affected by a range of economic, political and other external factors that affect business in the banking and financial sector in general and the ČSOB group's operations in particular. In addition, its business is subject to general global economic conditions, the development of the international financial markets, international political events, interest rate levels and volatility, currency exchange rates and general competitive factors in the banking industry. These factors also include the impact of the regulatory environment.

The Board of Directors believes that the following factors represent principal drivers for the development of the ČSOB group's business and thus its results of operations and financial condition.

1. Current recovery has not been capable of healing structural weaknesses present in many European economies. In the short-term perspective, however, a growth of the Czech economy creates an opportunity for the banking industry:
  - **Real GDP growth** in the Czech Republic may have a positive impact on the ČSOB group.
  - Increase in the **volume of imports and exports** may have a positive impact on the ČSOB group.
  - A fall in **unemployment** may cause a decrease in loan losses and thus have a positive impact on the ČSOB group.
2. The **interest rate** environment has an impact on the ČSOB group's business, particularly on the ČSOB group's net interest income and the net interest margin. With ČNB's repo rates at historical lows, the net interest margin continues to decrease.
3. With the change of **credit quality** of loans and receivables, both on-balance sheet and off-balance sheet, required provisioning ratios may be altered should the recovery ratio or the value of available collateral is also impacted.

4. Significant amounts held in **securities portfolio** may have to be revalued as a result of relevant changes in e.g. liquidity, volatility, pricing information, business climate, credit rating changes, regulatory actions or unanticipated changes in the competitive environment. ČSOB prefers to purchase bonds issued by government institutions, which account for majority of all bonds.
5. **Competition:** The EU legislation allows banks from other EU member states to easily enter the Czech banking market, thus possibly intensify the competitive environment.

## ČSOB Group Market Position

1st	<b>Total Loans<sup>1)</sup></b>	<b>19.7%</b>	↓
	Building savings loans <sup>1)</sup>	46.0%	↓
	Building savings deposits <sup>1)</sup>	39.2%	↑
	Mortgages <sup>1)</sup>	28.4%	→
	Leasing <sup>1)</sup>	18.8%	↑
2nd	<b>Total Deposits<sup>1)</sup></b>	<b>19.9%</b>	↑
	Mutuals funds <sup>1)</sup>	23.2%	↓
	Factoring <sup>2)</sup>	25.4%	↑
3rd	Pension funds <sup>3)</sup>	14.0%	↑
	SME/corporate loans <sup>1)</sup>	15.2%	↓
	Consumer lending <sup>1), 4)</sup>	10.5%	↑
4th	<b>Insurance<sup>5)</sup> – combined</b>	<b>7.1%</b>	↑
	Non-life insurance <sup>5)</sup>	6.9%	↑
	Life insurance <sup>5)</sup>	7.3%	↑

### Market shares as of 31 December 2016.

Arrows show Y/Y change.

The ranking is ČSOB's estimate. Market position in the insurance reflects combined position of the insurers belonging to the same business group.

1) Outstanding at the given date (including ČMSS).

2) New business in the year to the given date.

3) Number of clients at the given date.

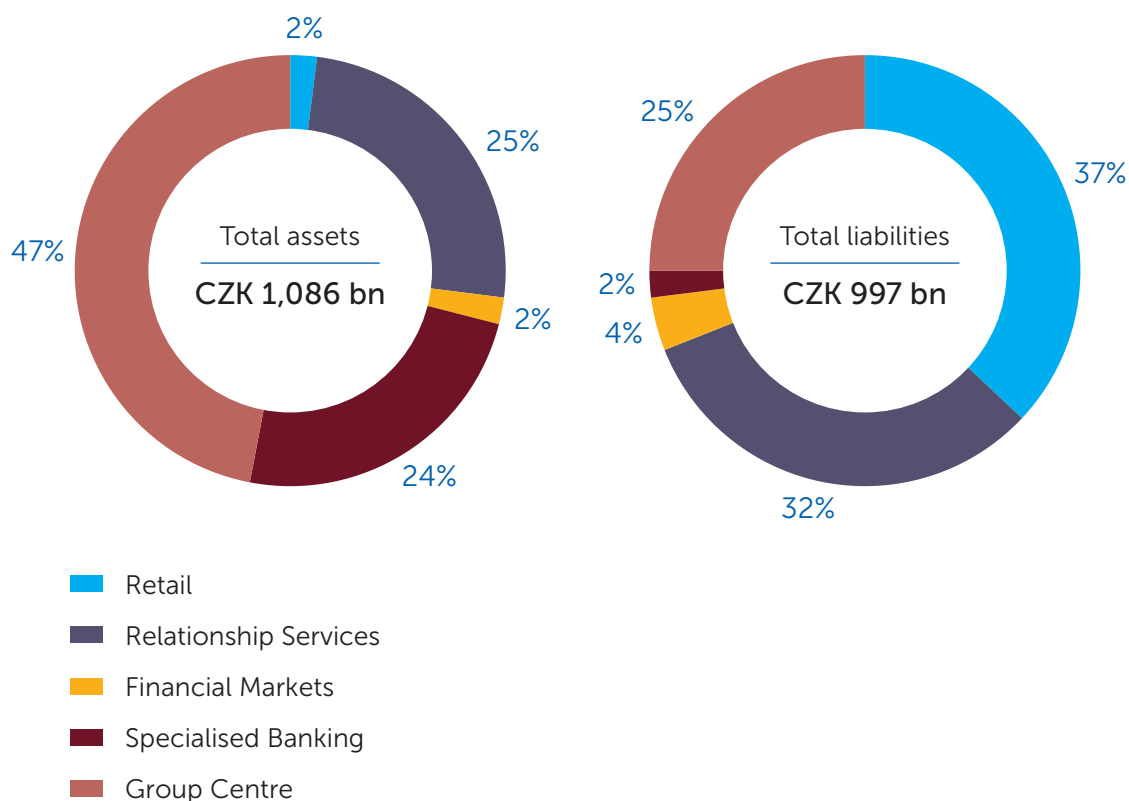
4) Retail loans excluding mortgages and building savings loans.

5) New business in the year according to gross written premium.

## Segment View

ČSOB group has **five segments**, which are the group's strategic business units: **Retail**, **Relationship Services**, **Financial Markets**, **Specialised Banking** and **Group Centre**. The strategic business units are managed separately based on the group's management and internal reporting structure.

### Total assets and liabilities by reported segments



## Retail

The ČSOB Retail segment represented 2% of ČSOB's assets and 37% of ČSOB's liabilities as at the 31 December 2016.

This segment contains client's deposits, consumer loans, overdrafts, payment solutions including payment cards and other transactions and balances with retail clients. Retail clients comprise private individuals and entrepreneurs. The former include affluent (with financial assets up to CZK 10 m) as well as all categories of mass customers.

As at 31 December 2016, the ČSOB group had approximately 2.7 million retail clients in the Czech Republic.

Retail clients benefit from ČSOB's **wide sales network** of 216 predominantly shared retail / SME branches, 49 PSB branches (Era Financial Centers) and approximately 3,000 PSB outlets of the Czech Post network. Clients can also use a wide network of 1,066 ATMs, including 80 contactless and 158 deposit ATMs.

## Most Notable Events and Trends

- **Consumer finance lending accelerated** in 2016. Outstanding volumes increased 18.9% year on year thanks to successful marketing campaigns targeted on loan refinancing, together with adjusted pricing, distribution focus and supported by revived market. The increase was fully driven by cash loans, while credit cards and overdrafts decreased year on year.
- The **market share in consumer lending increased** year on year to 10.5% and ČSOB maintained the third position on the market of consumer lending.
- **Client deposits increased**, mainly driven by current accounts and to a lesser extent by savings deposits, while term deposits decreased.
- **Number of transactions with cards issued by ČSOB increased** by 14.5% year on year, of which number of transactions at merchants increased by 19.4%. Volume of transactions increased by 8.0%, of which volume of transactions at merchants increased by 14.8%.
- The number of dedicated **insurance advisors at the bank branches increased** to 140 at the end of the year 2016.

Retail: Key Volumes (CZKm)	2016	2015	Y/Y change (%)
Credit portfolio – consumer loans	24,183	20,333	18.9
– of which credit cards and overdrafts	2,921	3,066	(4.7)
– of which cash loans	19,271	15,466	24.6

## Relationship Services

**The ČSOB Relationship Services segment comprised 25% of assets and 32% of liabilities of the ČSOB group as at the 31 December 2016.**

The Relationship Services segment includes SME, corporate and private banking clients. The Relationship Services segment contains clients' deposits, loans, overdrafts, leasing, payment solutions including payment cards and other transactions and balances with clients.

SME clients include small and medium sized enterprises with an annual turnover of less than CZK 300 m, housing cooperatives and municipalities. Corporate clients include domestic companies with annual turnover greater than CZK 300 m, local subsidiaries of international corporations, and selected institutional clients, including financial and public sector institutions. With regards to the corporate clients, ČSOB similarly to KBC principally targets mid-sized corporations and seeks to combine local market expertise, products and standards of service customary in developed markets. Private banking clients include private individuals with financial assets above CZK 10 m.

As at 31 December 2016, the ČSOB group had approximately 4,000 corporate, 130,000 SME and 7,000 private banking clients in the Czech Republic.

The ČSOB group has a sales network of **11 regional branches** devoted to serving corporate clients, including a specialized branch servicing the Financial and Public Sector, and **11 branches** for private banking clients. SME clients benefit from wide coverage of **216** predominantly shared **retail / SME branches** (including dual branded ČSOB + Era) and **49 PSB branches** (Era Financial Centers) are available mainly for cash transactions.

The ČSOB group provides SME and corporate clients with a **wide range of financial services**, from traditional account and payment management services and classic forms of investment

and working capital financing, to solutions for managing clients' foreign currency and interest rate risks, specialized financing, financing with EU support, acquisition and project financing, cash pooling and internet-based transactional systems. The range of its products combined with its distribution network has enabled the ČSOB group to become an important service provider in key product areas, including cash management, acquisition, export and online trade finance services.

ČSOB also offers a range of **products for institutional clients**. This range comprises both regular banking products tailored to meet the requirements of institutional clients, and specialized services in the areas of cash management, custody of securities, and fund depository services.

### Most Notable Events and Trends

- **The volume of the corporate credit portfolio** reached **CZK 149.1 bn** at the end of 2016 (up 2.8% year on year) and has grown continuously since late 2010. The major year on year loan growth was recorded in sectors: real estate, distribution & services and chemicals.
- **The growth of corporate loans** was driven by areas of **specialized finance** (which includes for example Project finance, Syndicated loans or Real estate finance), while the volume of plain vanilla loans as well as credit replacing bonds decreased year on year.
- **SME volumes increased** by 1.5% year on year driven by higher loans granted to core SME (micro, small and mid-sized companies).
- ČSOB group's **market share** of SME / corporate loans stood at 15.2% at the end of the year 2016.
- **ČSOB Leasing** kept its market leading position. **Outstanding volumes increased** driven by overall increase of new sales mainly in car financing supported by market improvement.
- The provision of new loans to clients was in many cases accompanied by an agreement on the protection of the interest rate exposure with positive effect on interest rate derivative business. The business of hedging transaction increased in 2016. One successful example was an agreement on the protection of interest rate exposure on the Bratislava bypass PPP (Public-private partnership) project in Slovakia, which was realised thanks to participation of ČSOB's Project Finance team.

Relationship Services: Key Volumes (CZKm)	2016	2015	Y/Y change (%)
Credit portfolio – corporate	149,098	145,051	2.8
Credit portfolio – SME	82,271	81,072	1.5
Credit portfolio – factoring	5,563	4,483	24.1
Credit portfolio – leasing	36,202	33,147	9.2

## Financial Markets

**The ČSOB Financial Markets segment represented 2% of ČSOB group's assets and 4% of its liabilities as at the 31 December 2016.**

The segment contains investment products and services to institutional investors and intermediaries, fund management activities and trading included in dealing services. The ČSOB Financial Markets segment focuses on client-driven activities for Retail, SME, corporate, private banking and institutional clients, while trading is a support business for sales activities.

## Specialised Banking

The ČSOB Specialised Banking segment represented 24% of ČSOB group's assets and 2% of its liabilities as at 31 December 2016.

The Specialised Banking segment contains mortgages, building savings, building savings loans, pension funds, mutual funds and asset management.

### Most Notable Events and Trends

- In 2016, **ČSOB expanded outstanding mortgage volumes** by 10.9% year on year as a result of favourable economic conditions including record low interest rates, ongoing increase of real estate prices and introduction of consumer credit regulation. 2016 was **the record high year** - ČSOB provided more than **31 thousand new mortgages** (+15.4% year on year) in the total amount of **CZK 64 bn** (+24.5% year on year) while total market increased by 9.4% year on year in number of new mortgages and increased 18.4% year on year in the total amount. Mortgages provided via various distribution channels are booked in Hypoteční banka. In 2016, the average size of new mortgage loan exceeded CZK 2.0 m and the interest rate was on averaged fixed for over 5 years.
- Outstanding **building savings loan portfolio declined** by 2.5% year on year, as did new sales, despite the record high quarter 4Q 2016, which was supported by new offer of unsecured loans introduced earlier this year. ČMSS maintained its market leading position in 2016.
- The volume of **pension funds increased** by 10.2% year on year driven mainly by increase of new sales and improving retention.
- Mutual funds and other AM increased** by 1.7% year on year, driven by structured/capital protected funds and other asset management products. Mutual funds increased by 0.5% year on year as decrease in mutual funds net sales was more than offset by positive performance effect.
- With effect from June 2016, ČSOB has become the 100% owner of **Top-Pojištění.cz** s.r.o., the brokerage company on the Czech market, which specializes in comparing insurance online.

Specialised Banking: Key Volumes (CZKm)	2016	2015	Y/Y change (%)
Credit portfolio – mortgages	256,689	231,533	10.9
Credit portfolio – building savings loans (55%)	64,310	65,986	(2.5)
Mutual funds and other AM (Outstanding volume, CZKm)	145,548	143,070	1.7
– of which structural/capital protected funds	20,598	19,326	6.6
– of which other mutual funds	64,161	65,030	(1.3)
– of which other assets management products	53,754	51,658	4.1



## Group Center

The Group Center comprised 47% of ČSOB group's assets and 25% of its liabilities as at 31 December 2016.

The segment consists of positions and results of Asset Liability Management (ALM), the Group's yield on real equity consisting of an interest charge on capital provided to subsidiaries which are a part of the Relationship Services and Specialised Banking segment, the results of the reinvestment of free equity of ČSOB, items not directly attributable to other segments and eliminations.

## Insurance

As at 31 December 2016, ČSOB Pojišťovna reached a 7.3% market share in life gross written premium and a 6.9% market share in non-life gross written premium (according to the Czech Insurance Association's methodology).

ČSOB Pojišťovna provides its clients with a wide range of insurance products, including single and regular premium life insurance as well as car (for individuals and corporate clients), house, accident, travel and industrial insurance. As at 31 December 2016, ČSOB Pojišťovna had over 1.078 million clients, comprising of individuals and business entities (including SME's as well as corporates). Insurance products are mainly distributed through the internal agent network, ČSOB group's branches and external brokers.

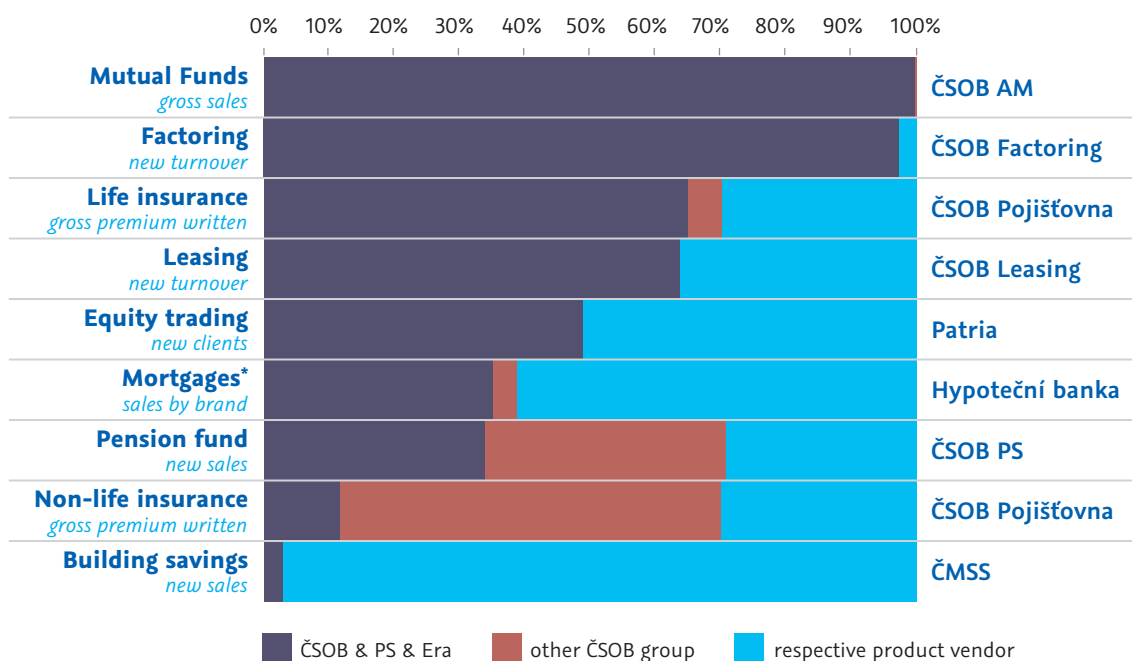
ČSOB Pojišťovna is rated by Standard & Poor's Rating Services. In October 2016, the Agency confirmed ČSOB Pojišťovna A- rating with a stable outlook and thus upheld the rating from the previous year.

Insurance: Key Volumes (CZKmn)	2016	2015	Y/Y change (%)
Single life insurance	2,747	3,964	(30,7)
Regular life insurance	4,571	2,658	72,0
<b>Life insurance total</b>	<b>7,318</b>	<b>6,622</b>	<b>10,5</b>
<b>Non-life insurance total</b>	<b>5,275</b>	<b>4,903</b>	<b>7,6</b>
<b>Total</b>	<b>12,593</b>	<b>11,525</b>	<b>9,3</b>
Amount of benefits paid to clients	7,920	9,147	(13,4)
Number of cases settled	219,359	207,163	5,9

## ČSOB Group Synergies

The concept of multibranding and multichannel distribution gives ČSOB group an opportunity to better serve its target client groups. The following chart documents the cross-selling activities within the ČSOB group. This distribution model allows the ČSOB group to combine diversification with specialization.

### New Production in 2016 – Shares of Distribution Channels per Product Type



The chart shows the volumes distributed in 2016 by the companies of the ČSOB group. Distribution by third parties is included in the figures for the respective product vendors.

\* The mortgage volumes originated by third parties are included under the specific brands under which they are sold by third parties.

## Definitions and Glossary of Financial Ratios

**Assets under management** include pension funds, mutual funds (assets under management in structured/capital protected funds, in other mutual funds), other asset management and assets under management of Slovak AM.

**Group deposits** is item Deposits received from other than credit institutions from the consolidated balance sheet, including ČMSS, building savings deposits.

**Capital adequacy ratio** is total regulatory capital / total RWA (according to CRR).

**Cost / income ratio** represents Operating expenses / operating income, Ytd.

**Credit cost ratio** represents total credit costs / average outstanding credit portfolio (loans, loans replacements and drawn credit commitments - e.g. guarantees) and non-sovereign bonds in credit book; Ytd., annualized.

**Leverage ratio** is Tier 1 capital / On-balance + Off-balance sheet items + Counterparty exposure for Derivatives and SFT + Add-ons (according to CRR).

**Loan portfolio** includes loans and receivables to other than credit institutions (including ČMSS, building savings loans) plus loans and receivables to credit institutions minus exposure to banks from inter-bank transactions plus credit replacing bonds (in HTM, AFS and FVPL portfolios).

**Loan-to-deposit ratio** represents loan portfolio (excluding ČMSS, building savings loans) / primary deposits.

**Primary deposits** are group deposits (excluding ČMSS, building savings deposits) minus repo operations with non-banking financial institutions plus deposits to credit institutions (excluding repo operations with credit institutions). Consistent with the internal liquidity management reporting system.

**Net interest margin** is net interest income / average interest earnings assets excluding repo operations; Ytd., annualized.

**Net stable funding ratio** is available amount of stable funding / required amount of stable funding (according to CRR).

**ROAA** is net profit for the year / average of total assets; Ytd., annualized.

**ROAE** is net profit for the year / average of total shareholders' equity; Ytd., annualized.

**Tier 1 ratio** is Tier 1 capital (CET1) / Total RWA (according to CRR).

## ABOUT US

### Company Profile

#### From ČSOB's History

- 1964** ČSOB established by the state as a bank to provide foreign trade financing and convertible currency operations in the then Czechoslovak market.
- 1993** Continuation of ČSOB's activities in both the Czech and Slovak market after the split of Czechoslovakia.
- 1999** ČSOB privatized – Belgium-based KBC Bank becoming the majority shareholder of ČSOB.
- 2000** Acquisition of Investiční a Poštovní banka (IPB).
- 2007** KBC Bank becoming ČSOB's sole shareholder after buying out all minority shareholders. New environmentally friendly building of ČSOB's headquarters in Prague – Radlice (Building of the Year 2007).
- 2008** As at 1 January, ČSOB's Slovak branch separated into a separate entity, fully controlled by KBC Bank via 100% of voting rights.
- 2009** In December, ČSOB sold its remaining interest in the Slovak activities to KBC Bank.
- 2013** The establishment of the separate Business Unit Czech Republic within the KBC Group.

#### ČSOB and ČSOB Group Profile

Československá obchodní banka, a. s. (hereinafter referred to as "ČSOB" or the "Bank") is operating in the Czech Republic as a **universal bank**. ČSOB is a wholly-owned subsidiary of the Belgian KBC Bank (since 1999, since 2007 fully). KBC Bank is a part of the integrated bank-insurance group KBC Group. As of 1 January 2013, KBC Group has organized its core markets activities into three business units – Belgium, Czech Republic (includes all KBC's business in the Czech Republic) and International Markets.

ČSOB provides its **services to all groups of clients**, i.e. Retail as well as SME, corporate and institutional clients. **In retail banking in the Czech Republic**, ČSOB is operating under main recognized brands – ČSOB (branches), Era (Financial centers) and Poštovní spořitelna (Postal Savings Bank – PSB; outlets of the Czech Post network). ČSOB offers to its clients a **wide range of banking products and services**, including the products and services of the entire ČSOB group.

**The ČSOB group** consists of the Bank and entities related with the Bank. ČSOB's financial group includes strategic companies in the Czech Republic controlled directly or indirectly by ČSOB, or KBC, which offer financial services, namely Hypoteční banka, ČSOB Pojišťovna, ČMSS, ČSOB Penzijní společnost, ČSOB Leasing, ČSOB Asset Management, ČSOB Factoring and Patria group.

**The ČSOB group's (Business Unit Czech Republic) product portfolio includes next to standard banking services:** financing housing needs (mortgages and building savings loans), insurance products, pension funds, collective investment products and asset management, specialized services (leasing and factoring) and services related to trading equities on financial markets.

With total assets of CZK 1,086 bn as at 31 December 2016 and a total net profit of CZK 15.1 bn in 2016, **the ČSOB group is one of the top three banking groups in the Czech Republic**. As at 31 December 2016, the ČSOB group had CZK 752 bn of group deposits (including ČMSS) and a loan portfolio of CZK 618 bn (including ČMSS).

## ČSOB Group in Figures

Distribution Platform	31. 12. 2016	31. 12. 2015
<b>Retail / SME branches and advisory centers</b>	<b>694</b>	<b>754</b>
ČSOB retail / SME branches <sup>2)</sup>	216	224
PSB / Era Financial centers	49	72
ČMSS advisory centers	308	338
Hypoteční banka centers	29	29
ČSOB Pojišťovna branches	92	91
<b>ČSOB Private Banking branches</b>	<b>11</b>	<b>12</b>
<b>Leasing branches</b>	<b>10</b>	<b>10</b>
<b>ČSOB corporate branches</b>	<b>11</b>	<b>11</b>
<b>PSB outlets of the Czech Post network</b>	<b>ca. 3,000</b>	<b>ca. 3,100</b>
<b>ATMs (the Bank)<sup>1)</sup></b>	<b>1,066</b>	<b>1,062</b>
<b>Clients (the Bank only; in millions)</b>	<b>2.803</b>	<b>2.831</b>
<b>Internet banking – users (in millions)</b>	<b>1.566</b>	<b>1.538</b>
– transactions (in millions)	<b>51.694</b>	<b>49.718</b>

1) Including ATMs of cooperating banks.

2) As of 30 June 2016 figure includes dual branded branches (ČSOB + Era). Figures of retail / SME branches and PSB / Era Financial centers for 2015 have been restated in accordance with methodology changes.

Employees (FTEs)	31. 12. 2016	31. 12. 2015
Employees of the ČSOB group (FTEs) <sup>1)</sup>	8,232	8,203
of which the Bank	7,071	7,099

1) Excluding employees of the joint venture and associated companies, including ICT employees which were transferred from KBC Group back to ČSOB.

Annual reports and other information about ČSOB and the ČSOB group are available at [www.csob.cz](http://www.csob.cz).

## KBC Group Profile

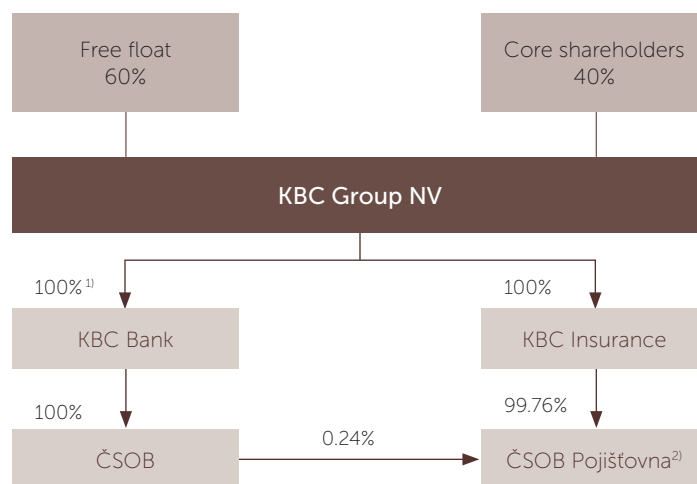
ČSOB is a wholly-owned subsidiary of KBC Bank NV, whose shares are held (directly or indirectly) by KBC Group NV. KBC Bank and KBC Group are both based in Brussels, Belgium.

KBC is an integrated bank-insurance group, catering mainly for Retail, private banking, SME and mid-cap clients. Geographically, KBC focuses on its home markets of Belgium, the Czech Republic, Slovakia, Hungary, Bulgaria and Ireland. Elsewhere in the world, KBC is present in several other countries to support corporate clients from its core markets. As of the end of 2016, the KBC Group served over 10 million clients in its home markets, and employed approximately 38 000 employees, roughly half of which in Central and Eastern Europe.

The majority of KBC Group's shares is traded publicly on the Euronext Exchange in Brussels. Around 40% of KBC Group's shares is held by KBC Group's core shareholders (KBC Ancora, Cera, MRBB and the Other core shareholders).

### The Simplified Scheme of the KBC Group

(as at 31 December 2016)



Percentages in the chart denote the ownership interest.

1) One share is held by KBC Insurance.

2) Voting rights in ČSOB Pojišťovna: 40% ČSOB, 60% KBC Insurance.

For an overview of companies of the KBC group please refer to KBC's corporate website [www.kbc.com](http://www.kbc.com) (section About us – Our structure).

### KBC Group in Figures

		31. 12. 2016	31. 12. 2015
Total assets	EURbn	275.2	252.4
Loans and advances to customers	EURbn	133.2	128.2
Deposits from customers and debt securities	EURbn	177.7	170.1
Net profit, group share	EURm	2,427	2,639
Common equity ratio, group level (Basel III, fully loaded)	%	15.8	14.9
Cost / income ratio, banking	%	55	55

## Long-term ratings (as at 20 March 2017)

	Fitch	Moody's	S & P
KBC Bank	A	A1	A
KBC Insurance	-	-	A-
KBC Group	A	Baa1	BBB+

Annual reports and other information about KBC are available at KBC's corporate website [www.kbc.com](http://www.kbc.com).

## ČSOB as a Controlled and Controlling Entity

Within the KBC group and the ČSOB group, ČSOB acts as both a controlled entity and a controlling entity.

ČSOB is a **controlled entity** of the sole shareholder KBC Bank NV (ID No. 90029371), or more precisely, of its shareholder KBC Group NV (ID No. 90031317). Both KBC Bank and KBC Group have their registered addresses at: Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek), Belgium.

The control is exercised by decisions of the sole shareholder when exercising the general meeting's competence according to the Corporations Act. Within the limits stipulated by law, the controlling entity also exercises influence through its representatives in the Supervisory Board or the Board of Directors. The control covers cooperation and coordination in the area of risk management, audit functions and prudential rules. The Board of Directors is responsible for the management of business.

ČSOB follows the legislation applicable on the territory of the Czech Republic which protects against abuse of position of the controlling entity. In particular, ČSOB activities are governed by the Corporations Act, regulatory rules for banks and tax law including transfer pricing principles. ČSOB is also subject of supervision of the CNB. The regulatory and supervisory system is supplemented by the internal control system which is secured by the Board of Directors, the Supervisory Board, the Audit Committee and specialized departments of internal audit, compliance and risk management. The Board of Directors is responsible for internal control system efficiency.

ČSOB did not hold any shares of KBC Bank or KBC Group between 1 January and 31 December 2016.

ČSOB is also a **controlling entity**. For information on companies controlled by ČSOB as at 31 December 2016 please refer to the chapter Companies of the ČSOB group.

ČSOB is not dependent on any entity in the concern into which ČSOB belongs.

## Corporate Social Responsibility

Designed to follow its general business strategy, the ČSOB's corporate social responsibility and sustainability policy contributes fundamentally to meeting the Bank's long-term commitment of accommodating the clients' needs and providing them with services and products responding to their expectations. It is by virtue of its responsible approach to business that ČSOB seeks to nurture good relationships with its customers, employees, business partners, governmental authorities and NGOs while paying close attention to impacts of its business activities on the environment as well as to the transparency of all its decisions and processes.

### Priorities of ČSOB's social responsibility

- Financial literacy
- Environmental responsibility
- Entrepreneurship
- Longevity (and the related topics)

We seek to fill each of the topics above with specific projects and, at the same time, look for further opportunities to extend our product and service offerings to match the needs of people in various life situations. Recruited from among our colleagues, ČSOB trainers have already had 17 lectures on financial literacy at 16 basic and high schools around the Czech Republic since September 2016. The insightfulness and relevance of the topic is proved by the fact that we have received more than 160 requests for discussions on this topic with children and the number of schools showing their interest in this sort of cooperation keeps on growing. The support to entrepreneurial activities focuses – in our case – on female entrepreneurs and social businesses, and we also work on a new approach to starting-up entrepreneurs. All companies rendering retail services within the ČSOB Group have already got involved in the Longevity programme. In addition to ČSOB, the list comprises mainly ČSOB Pojišťovna, Hypoteční banka, ČSOB Leasing, ČSOB Penzijní společnost, and Patria. We have received ISO 50001 – an important environmental management certificate fostering our environmentally responsible efforts. Environmental considerations are primarily taken into account in the design of our two new buildings – in Prague-Radlice and in Hradec Králové.

In 2016, ČSOB contributed to initiatives addressing investment in society and various philanthropic projects with a total sum of CZK 33.7 m.

### Awards Earned in 2016

In 2016, as in the past, ČSOB ranked among the best in the country for corporate sustainability and responsibility (CSR) and was honoured with many awards.

**Fincentrum**, a Czech financial service provider, awarded ČSOB:

- Third place award in the Bank without Barriers category,
- Third place award in the Most Trustworthy Bank of the Year category.

In the **TOP Responsible Company 2016** contest, **Business for the Society** awarded ČSOB:

- Silver certificate in the Top Responsible Large Company category,
- Bronze certificate in the Community Project for Public Benefit category,
- Bronze certificate in the Responsible Reporting category.



**The Donors Forum** awarded ČSOB:

- The first place for the Corporate Social Responsibility Annual Report – corporate,
- The second place for the Employee Fundraising Collection.

## Selected CSR Activities in 2016

### Responsible Business

#### The Good Will Card

The Good Will Card is an exclusive debit card offered to Private Banking clients making it possible for the cardholders to raise funds for socially beneficial projects. The more they pay by the Card, the more funds are remitted to charity. In 2016, the proceeds from the Card totalled CZK 2,262 ths and were distributed in two rounds among twenty Czech non-profit organizations including neurological rehabilitation of children with cerebral palsy, refurbishment of a training kitchen for people with visual impairment, half-year operations of a training workplace for a person on wheelchair, purchase of bicycles for children in children's homes, workshops for senior citizens in the National Technical Museum, a shelter for children endangered by domestic violence, home-based palliative care for children, etc.

#### ČSOB Stabilisation of Social Enterprises Grant Programme

In the fourth year of the grant programme, 6 social enterprises were supported by CZK 840 ths. Each of them received both a financial contribution and expert advisory aimed at improving their efficiency. Although focused on different business sectors, all of the enterprises awarded with the ČSOB grant employ persons suffering from health impairments. Among others, the list of grant recipients includes a graphic studio and companies offering gardening or massage services.

### Philanthropy

We seek to be a good partner or neighbour wherever we are present or do our business. This is why we are interested in the needs of the Czech society and respond to the current topics with our annually announced grant programmes. We support enhancement of financial literacy and online security, and focus on further development of social entrepreneurship and professionalization of the NGO sector. The removal of social and physical barriers is a big topic for us.

ČSOB's long-term partnerships include Výbor dobré vůle – Nadace Olgy Havlové (Committee of Good Will – the Olga Havel Foundation), Nadační fond Mathilda (Mathilda Endowment Fund), Asociace občanských poraden (Association of Citizens' Advisory Centres), Poradna při finanční tísni (Debt Advisory Centre), Nadace Charty 77 – Konto Bariéry (The Charta 77 Foundation – Barriers Account), Nadační fond Českého rozhlasu – Světluška (Czech Radio Endowment Fund – the Firefly project), Domov Sue Ryder (Sue Ryder Home), Sdružení Neratov (Neratov Association), Česká asociace paralegiků (Czech Association of Paralegals), Linka bezpečí (Safety Line Association), Nadační fond Rozum a cit (Sense and Sensibility Endowment Fund) and many others. For several years, ČSOB has also cooperated with organizations focusing on further development of CSR and philanthropy in the Czech Republic – Fórum dárců (Donors Forum) and Byznys pro společnost (Business for Society).

#### ČSOB Helps the Regions

ČSOB Helps the Regions is a grant programme supporting compelling projects that contribute, in one way or another, to improving quality of life of people around the Czech Republic. There were two grant cycles in 2016 involving 112 non-profit organisations, during which CZK 7,263 ths

was distributed. Consisting of financial donations from the public and donations from the Bank, the amount is received by non-profit organizations based on their fundraising success at [www.csobpomaharegionum.cz](http://www.csobpomaharegionum.cz). For ČSOB Helps the Regions, 2016 was the most successful year since it was established in 2013.

## ČSOB Education Programme

For a long time, we have been supporting further education and financial literacy of the Czech public – adults, children and youth. The Programme is a tool to identify interesting projects focusing on financial literacy and, moreover, we are able to respond to the current educational topics such as online security. In 2016, we distributed CZK 1,889 ths among 7 projects aimed at interactive forms of increasing financial literacy and 8 projects dealing with online security.

## Employee Engagement

### Volunteering

Volunteering has been one of the ČSOB's key corporate responsibility topics for a long time. A paid day-off that can be taken by each employee and spent by volunteering in a non-profit organisation is a popular and widely used employee benefit. Initiated for the first time in 2007, volunteering days take place in ČSOB on a regular basis. Hundreds of colleagues get involved in nation-wide volunteering activities – it is now more than 900 employees each year.

Selection of a non-profit organisation that would appreciate expert advice or a helping hand depends on the preferences of volunteers who can choose from an extensive list of non-profit organisations and volunteering activities listed on the web site at [www.zapojimse.cz](http://www.zapojimse.cz). If a volunteering event has been jointly selected by colleagues from one team (and this is the case in 80% of all activities), the volunteering days serve as natural team-building opportunities. Employees can sign in for a volunteering day in any region of the Czech Republic at any time during the year.

### Together with ČSOB

Support of the concept of individual donorship is considered to be one of the ČSOB's key approaches to social responsibility and sustainability. The purpose of the Together with ČSOB matching fund is to support the ČSOB's employees in their philanthropic efforts and match the planned fundraising events with their sympathizers across the ČSOB Group. In 2016, the matching fund was used to support 24 projects for a good cause by a sum exceeding CZK 1 m (employees donated CZK 591 ths and ČSOB donated CZK 477 ths).

## Diversity

ČSOB supports equal opportunities, higher involvement of women in management, enables to work people with disabilities and supports work life balance.

### Equal Opportunities – Women Support

In 2016, ČSOB has continued in existing development projects focused on diversity. This includes the mentoring programme **Womentoring**, which is oriented on women – managers. They were last year by members of ČSOB's Board of Directors, got a more complex view on their agenda and could have considered their own career in a broader scope. 9 women were involved in this programme. A community called **The Gold Fish** focusing on professional and personal development of women - managers has existed in ČSOB already for 5 years.

At the end of 2016, the equal opportunities efforts resulted in nomination of a woman as member of ČSOB's Board of Directors.

## Support of Employment People with Disabilities

In 2016, ČSOB continued in internal campaign **Fandím OZP** (I Cheer for the Disabled) oriented on employment of people with disabilities. An internal communication campaign **Otevři svůj příběh** (Open up your story) focused on colleagues with disabilities was held all over the year.

## Work Life Balance

ČSOB strives to help its employees to reconcile work and personal life via **a wide range of supporting activities and services**. They vary from flexible working hours and part-time jobs to possibility to work from home and also shared work places.

Within the **Programme for Parents**, ČSOB keeps on supporting mothers and fathers on parental leave. For leaving or returning parents adaptation workshops were organized so that they could have better grasped the new role. In general, we concentrate on maintaining their contact with work and on supporting earlier return of parents to work.

At the end of 2016, we surveyed needs of employees aged 55+. We want to use its findings for further implementation.

*For more information please refer to the ČSOB Group Report to Society 2016 and to the website at [www.csob.cz/csr](http://www.csob.cz/csr)*

## COMPANIES OF THE ČSOB GROUP

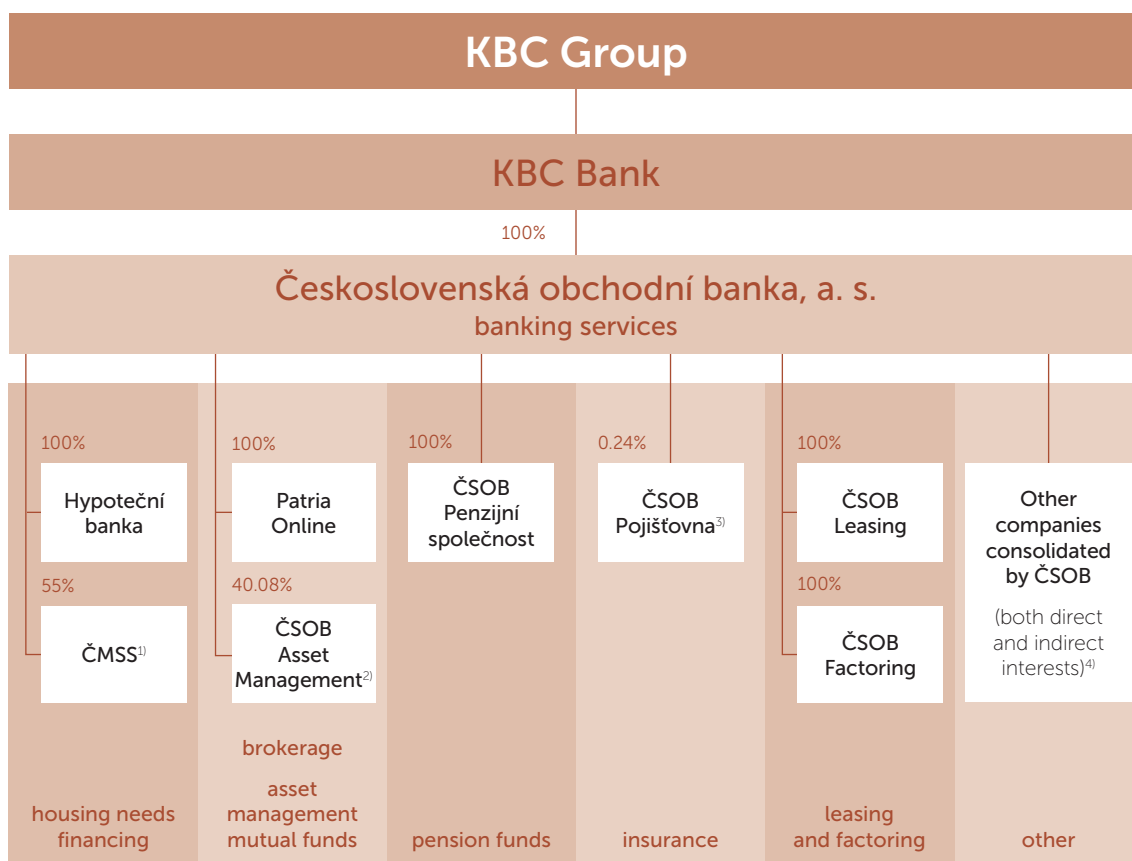
### ČSOB group

The ČSOB group is the leading player in Czech financial services industry. It is a part of the international bank-insurance KBC group which is active in Belgium and the CEE region.

As at 31 December 2016, ČSOB had ownership interests in 32 legal entities and, in addition to ČSOB, other 29 companies were included in the group of consolidated companies.

**The ČSOB group offers its clients in the Czech Republic the following types of services:**

banking services, building savings and mortgages, securities brokerage, asset management, mutual fund, pension funds, insurance, leasing and factoring.



Percentages show ČSOB's ownership interests on company's equity as at 31 December 2016. Percentages on company's voting rights are stated in this part of ČSOB Annual Report 2016.

1) 45% of shares owned by Bausparkasse Schwäbisch Hall; consolidated in ČSOB by an equity method.

2) 59.92% of shares owned by KBC Participations Renta C; consolidated in ČSOB by an equity method.

3) 99.76% of shares owned by KBC Insurance; consolidated in ČSOB by an equity method.

4) A complete list of companies consolidated by ČSOB is stated in this part of ČSOB Annual Report 2016.

## Hypoteční banka, a.s.



Date of establishment:	10. 1. 1991
Business activities:	Providing of mortgage loans and issuance of mortgage bonds
Identification number:	13584324
Registered capital:	CZK 5,076,336 ths
Shareholders:	100% ČSOB

### Contact

Address: Radlická 333/150  
150 57 Praha 5

Telephone +420 224 116 515

E-mail: [info@hypotecnibanka.cz](mailto:info@hypotecnibanka.cz)

Internet: [www.hypotecnibanka.cz](http://www.hypotecnibanka.cz)

Indicator		2016	2015
Total assets*	CZKm	262,513	236,195
Loans and advances to customers*	CZKm	254,078	228,340
Total equity*	CZKm	34,172	33,647
Profit for the year after tax*	CZKm	3,206	2,990
Total volume of new mortgage loans (according to the Ministry of Regional Development; CZ)	CZKm	63,764	51,221

\* EU IFRS, audited.

Branches		29	29
Agents and brokers	ca.	4,164	4,010

Hypoteční banka (HB) is a specialist in providing of mortgage loans. It is a leader in the mortgage market and pioneers innovations. In 2007, HB offered as the first on the market the possibility to arrange a mortgage online. Four times a year publishes HB Index – the index of residential property prices and tailors the appearance of its branches to a pleasant home environment.

In 2016, Hypoteční banka provided 31,400 mortgage loans in total volume CZK 63.8 bn (the highest in the history of the bank). For the ninth time in a row HB defended its position as the market leader with a market share of 29.2% (new loans).

Last year, Hypoteční banka became the best employer in the financial sector, received Aon Best Employer 2016 award in Financial services category, based on a survey of satisfaction and motivation of its employees.

Furthermore, Hypoteční banka won the third place in the category Mortgage of the Year with a product "Pěkná hypotéka". Website of Hypoteční banka won the second place in the competition among banks WebTop 100. Service "Bezpečné financování" won the Silver Crown in the category Mortgages in competition Gold Crown. In 2016, HB officially re-opened the third branch with Living room concept in Prague 5.

## Českomoravská stavební spořitelna, a.s.

Date of establishment:	26. 6. 1993
Business activities:	Building savings and loans
Identification number:	49241397
Registered capital:	CZK 1,500,000 ths
Shareholders:	55% ČSOB 45% Bausparkasse Schwäbisch Hall



### Contact

Address: Vinohradská 3218/169  
100 17 Praha 10

Telephone: +420 225 221 111

Fax: +420 225 225 999

E-mail: info@cmss.cz

Internet: www.cmss.cz

Indicator		2016	2015
Total assets*	CZKm	149,536	153,215
Volume of loans and bridging loans (Retail)*	CZKm	114,291	117,378
Volume of client deposits*	CZKm	138,468	141,980
Total equity*	CZKm	9,741	9,748
Profit for the year after tax*	CZKm	1,176	1,104

\* EU IFRS, audited.

Advisory centers		308	338
Tied agents	ca.	1,920	1,970

In the long run, ČMSS has been the most popular building savings society on the Czech market. ČMSS won the award Building Society of year 2016.

In 2016, ČMSS achieved the total target amount of CZK 79.5 bn (i.e. market share of 46.5%) and concluded new construction loans and bridging loans of CZK 23.4 bn (i.e. market share of 48.9%).\*

\* According to methodology of MF ČR.

**Patria Online, a.s.**

Date of establishment:	27. 10. 1994
Business activities:	Creation of web pages in electronic form, automated data processing, conversion of media into electronic form and their further distribution
Identification number	61859273
Registered capital:	CZK 101,000 ths
Shareholders:	100% ČSOB

**Contact**

**Address:** Jungmannova 745/24  
110 00 Praha 1

**Telephone:** +420 221 424 178

**Fax:** +420 221 424 204

**E-mail:** info@patria.cz

**Internet:** www.patria.cz

Indicator		2016	2015
Profit for the year after tax (Patria group)*	CZKm	233	357
Number of orders realized through personal brokers and the online trading platform WebTrader (Patria Finance)	ca.	157,900	120,500
Number of clients (Patria Finance)	ca.	23,000	22,000

\* EU IFRS, unaudited.

The main activity of Patria Online is providing information on financial and capital markets through the Internet platform [www.patria.cz](http://www.patria.cz). The subsidiaries, Patria Finance and Patria Corporate Finance, provide investment banking services in the areas of securities trading and mergers and acquisitions of companies. Patria Finance services also include investment research, both for the CEE region and the developed markets of Western Europe and the USA. Securities trading and brokerage is offered through the Internet portal [www.patria-direct.cz](http://www.patria-direct.cz).

In 2016, securities trading focused dominantly on stock markets. The subsidiary, Patria Finance (the securities trader), serves more than 23,000 clients with the volume of AUM exceeding CZK 43 bn.

## ČSOB Asset Management, a.s., investment company



Date of establishment:	3. 7. 1998
Business activities:	Collective and individual portfolio management as per license by the CNB
Identification number:	25677888
Registered capital:	CZK 499,000 ths
Shareholders:	59.92% KBC Participations Renta C 40.08% ČSOB

### Contact

Address: Radlická 333/150  
150 57 Praha 5

Telephone: +420 224 116 702

Fax: +420 224 119 548

E-mail: csobam@csob.cz

Internet: www.csobam.cz

Indicator		2016	2015
Total assets managed by ČSOB AM <sup>1), 2)</sup>	CZKkm	208,327	199,772
Total assets in funds distributed by the ČSOB group <sup>2), 3)</sup>	CZKkm	100,124	99,173
Market share (according to methodology of AKAT) <sup>4)</sup> – total assets in funds		23.2%	26.0%

1) EU IFRS, unaudited.

2) According to methodology of Czech Capital Market Association (AKAT); total statistic including funds and asset management.

3) Local and foreign funds distributed by the ČSOB group.

4) Market share of 2015 has been restated according to methodology of AKAT.

ČSOB AM provides to its clients investment services of asset management, collective investment services, including the management of local mutual funds and the distribution of the KBC group's funds in the Czech Republic and is one of the leading companies on the Czech market. ČSOB AM also participates in product development for the entire ČSOB group. ČSOB AM offers services to clients via ČSOB branches, outlets of the Czech Post network, Era financial centers and Patria Finance.

In 2016, ČSOB AM created more than 30 funds, of which more than two-thirds are structured. The offer for ČSOB Premium clients was extended, among others, by a new premium profile funds product line. In September 2016, ČSOB AM launched on the market the unique bond fund ČSOB Úrokové strategie, which can, unlike common bond funds, profit from interest rate growth. ČSOB AM was awarded the first place in the category Guaranteed Funds with the structured fund Optimum Fund ČSOB Potravín a nápojů 1 in the Finparáda Financial Product of the Year 2016 competition.



## ČSOB Penzijní společnost, a. s., a member of the ČSOB group



**Penzijní společnost**

### Contact

Address: Radlická 333/150  
150 57 Praha 5

Telephone: +420 495 800 600

Fax: +420 224 119 536

E-mail: csobps@csob.cz

Internet: www.csob-penze.cz

Date of establishment:	26. 10. 1994*
Business activities:	Activities related to the pension savings
Identification number:	61859265
Registered capital:	CZK 300,000 ths
Shareholders:	100% ČSOB

\* Date of establishment of ČSOB PF Stabilita. ČSOB PS was incorporated on 1 January 2013 through transformation of ČSOB PF Stabilita (the Transformed fund).

Indicator		2016	2015
Funds registered in favour of participants of the Transformed fund Stabilita	CZKm	42,320	39,245
– of which contributions of participants	CZKm	33,400	30,920
Participant funds in pension funds <sup>1)</sup>	CZKm	0	205
Participant funds in participation funds	CZKm	2,986	1,594
Profit for the year after tax <sup>2)</sup>	CZKm	143	82

1) Closed as of 31 December 2015.

2) EU IFRS, audited.

Customers	ca.	636,000	650,000
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Pension savings perceived as a basic savings product for each of us. The aim of ČSOB Penzijní společnost is to create responsible clients and pension savings makes clients responsible. Clients are offered simple and effective solutions that help in arranging pension savings and its use. Intuitive new website offers on-line signature of contracts and pension portal displays contractual information about client and the savings and allows clients to initiate changes. For 2015, the company was awarded the prestigious Superbrands 2016 award. In 2016, the company trusted more than 636,000 clients who have entrusted it with more than 45 billion crowns.

## ČSOB Pojišťovna, a. s., a member of the ČSOB holding

Date of establishment:	17. 4. 1992
Business activities:	Life and non-life insurance
Identification number:	45534306
Registered capital:	CZK 2,796,248 ths
Shareholders:	
<i>Registered capital</i>	99.76% KBC Insurance 0.24% ČSOB
<i>Voting rights</i>	60% KBC Insurance 40% ČSOB



### Contact

Address: Masarykovo nám. 1458  
532 18 Pardubice,  
Zelené předměstí

Telephone: +420 467 007 111  
+420 800 100 777

Fax: +420 467 007 444

E-mail: info@csobpoj.cz

Internet: www.csobpoj.cz

Indicator		2016	2015
Total assets*	CZKm	42,220	40,120
Total equity*	CZKm	4,936	4,804
Profit for the year after tax*	CZKm	869	716
Gross written premium life insurance	CZKm	7,318	6,623
Gross written premium non-life insurance	CZKm	5,275	4,903

\* EU IFRS, audited.

Branches		92	91
Customers, comprising individuals and business entities, including small and medium-sized businesses, as well as large corporations	ca.	1,078,834	1,104,000

ČSOB Pojišťovna is a universal insurance company providing a broad range of life and non-life insurance products for both individuals and companies. Insurance products are mainly distributed through tied agents, brokers and the ČSOB group's branches.

In 2016, ČSOB Pojišťovna posted a net profit of CZK 869 m mainly thanks to good business results. Gross written premium reached CZK 12.6 bn. Market share increased by 0.3 percentage point to 7.1% in 2016.

## ČSOB Leasing, a.s.

Date of establishment:	31. 10. 1995
Business activities:	Financial services
Identification number:	63998980
Registered capital:	CZK 3,050,000 ths
Shareholders:	100% ČSOB



### Contact

Address: Na Pankráci 310/60  
140 00 Praha 4

Telephone: +420 222 012 111

Fax: +420 271 128 028

E-mail: info@csobleasing.cz

Internet: www.csobleasing.cz

Indicator		2016	2015
Total assets <sup>1)</sup>	CZKm	40,470	35,374
Amounts due from clients (gross) <sup>1)</sup>	CZKm	36,222	33,163
Total equity <sup>1)</sup>	CZKm	8,064	8,254
Profit for the year after tax <sup>1)</sup>	CZKm	487	533
Volume of new leasing business <sup>2)</sup>	CZKm	17,898	18,376

1) EU IFRS, unaudited.

2) According to methodology of Czech Leasing and Financial Association (ČLFA); Initial investment

Branches	10	10
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ČSOB Leasing is a universal leasing company with 21-years of business experience. ČSOB Leasing is a leader on the leasing market in the Czech Republic.

ČSOB Leasing provides financing for light and heavy means of transport, machinery and equipment, including financing assets with high acquisition prices.

ČSOB Leasing product range 2016 includes specialties: the financing of electric vehicles and hybrids, program for permanent mobility (AUTOPILOT Assistance), including products with advantage of a subsidy programs.

In 2016, ČSOB Leasing concluded more than 21 thousands of new contracts and provided financing in the total amount of CZK 17.9 bn.

**ČSOB Factoring, a.s.**

Date of establishment:	16. 7. 1992
Business activities:	Factoring
Identification number:	45794278
Registered capital:	CZK 70,800 ths
Shareholders:	100% ČSOB

**Contact**

Address: Benešovská 2538/40  
101 00 Praha 10

Telephone: +420 267 184 805

Fax: +420 267 184 822

E-mail: info@csobfactoring.cz

Internet: www.csobfactoring.cz

Indicator		2016	2015
Total assets*	CZKm	5,261	4,186
Amounts due from clients (gross)*	CZKm	5,563	4,483
Total equity*	CZKm	914	882
Profit for the year after tax*	CZKm	81	99
Turnover of receivables	CZKm	33,261	31,737

\* EU IFRS, unaudited.

ČSOB Factoring has been providing factoring services to its clients for almost twenty five years. Thanks to the quality of services the market share has exceeded 25% in 2016.

In 2016, the volume of receivables assigned to ČSOB Factoring increased by 4.8% and reached CZK 33.3 bn.

ČSOB Factoring is one of the founding members of the Association of Factoring Companies in the Czech Republic and a member of the Czech Leasing and Financial Association.

## Companies of the ČSOB Group

(as at 31 December 2016)

Legal Entity				Share of ČSOB in:				Indirect Share of ČSOB via	Cons. EU IFRS
ID No.	Business Name of Legal Entity	Registered Office	Registered Capital	Registered Capital			Voting Rights		
	Business Activities		CZK	Total	Direct	Indirect	%		

### Controlled Companies

63987686	<b>Bankovní informační technologie, s.r.o.</b> Automated data processing and software development; creation of a network of payment card reading terminals	Praha 5, Radlická 333/150	20,000,000	100.00	100.00	none	100.00	none	Y
26760401	<b>Centrum Radlická a.s.</b> Real estate activity; rent of flats and non-residential spaces	Praha 5, Radlická 333/150	500,000,000	100.00	100.00	none	100.00	none	Y
27081907	<b>ČSOB Advisory, a.s.</b> Activity of entrepreneurial, financial, economic and organisation advisors	Praha 5, Radlická 333/150	2,000,000,000	100.00	100.00	none	100.00	none	Y
45794278	<b>ČSOB Factoring, a.s.</b> Factoring and related services	Praha 10, Benešovská 2538/40	70,800,000	100.00	100.00	none	100.00	none	Y
63998980	<b>ČSOB Leasing, a.s.</b> Leasing	Praha 4, Na Pankráci 310/60	3,050,000,000	100.00	100.00	none	100.00	none	Y
27151221	<b>ČSOB Leasing pojišťovací makléř, s.r.o.</b> Insurance broker	Praha 4, Na Pankráci 60/310	2,000,000	100.00	none	100.00	100.00	ČSOB Leasing	Y
61859265	<b>ČSOB Penzijní společnost, a. s., a member of the ČSOB group</b> Pension insurance	Praha 5, Radlická 333/150	300,000,000	100.00	100.00	none	100.00	none	Y
27924068	<b>ČSOB Property fund, a.s.<sup>2)</sup></b> Real estate services, administration and maintenance of real estate	Praha 5, Radlická 333/150	878,000,000	61.61	59.79	1.82	95.67	ČSOB AM, ČSOB Pojišťovna	Y
61251950	<b>Eurincasso, s.r.o.</b> Activity of economic and organisation advisors; recovery of receivables	Praha 10, Benešovská 2538/40	1,000,000	100.00	none	100.00	100.00	ČSOB Factoring	Y
13584324	<b>Hypoteční banka, a.s.</b> Mortgage banking	Praha 5, Radlická 333/150	5,076,336,000	100.00	100.00	none	100.00	none	Y
02623111	<b>SousedecZ s.r.o.</b> Development of housing community network	Praha 5, Radlická 333/150	10,000	100.00	none	100.00	100.00	Hypoteční banka	Y
25617184	<b>Merrion Properties s.r.o.</b> Real estate activity; rent of flats and non-residential spaces	Praha 5, Radlická 333/150	6,570,000	61.61	none	61.61	100.00	ČSOB Property fund	Y
00000949	<b>MOTOKOV a.s. in liquidation</b> Wholesale of machines and technical equipment	Praha 5, Radlická 333/150	62,000,000	70.09	0.50	69.59	70.09	ČSOB Advisory	Y
61859273	<b>Patria Online, a.s.</b> Creation of web pages in electronic form, automated data processing, conversion of media into electronic form and their further distribution	Praha 1, Jungmannova 745/24	101,000,000	100.00	100.00	none	100.00	none	Y
26455064	<b>Patria Finance, a.s.</b> Securities trader	Praha 1, Jungmannova 745/24	150,000,000	100.00	none	100.00	100.00	Patria Online	Y
25671413	<b>Patria Corporate Finance, a.s.</b> Financial advisory	Praha 1, Jungmannova 745/24	1,000,000	100.00	none	100.00	100.00	Patria Online	Y
05154197	<b>Patria investiční společnost, a.s.</b> Management of investment funds	Praha 1, Jungmannova 745/24	10,000,000	100.00	none	100.00	100.00	Patria Online	Y
02451221	<b>Radlice Rozvojová, a.s.</b> Real estate activity; rent of flats and non-residential spaces	Praha 5, Radlická 333/150	186,000,000	100.00	100.00	none	100.00	none	Y
99999999 <sup>3)</sup>	<b>TEE SQUARE LIMITED, Ltd.</b> Advisory services for investment funds in the Caribbean area	British Virgin Islands, Tortola, Road Town, Third Floor, The Geneva Place, P.O.Box 986	10,514,656	100.00	100.00	none	100.00	none	Y
27388239	<b>Top-Pojištění.cz s.r.o.</b> Arranging insurance	Praha 4, Lomnického 1705/9	200,000	100.00	100.00	none	100.00	none	Y

Legal Entity				Share of ČSOB in:				Indirect Share of ČSOB via	Cons. EU IFRS
ID No.	Business Name of Legal Entity	Registered Office	Registered Capital	Registered Capital			Voting Rights		
	Business Activities			Total	Direct	Indirect			
			CZK	%	%	%	%	Y/N	

### Joint Venture

49241397	Českomoravská stavební spořitelna, a.s. Building savings bank	Praha 10, Vinohradská 3218/169	1,500,000,000	55.00	55.00	none	55.00	none	Y
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### Others

26199696	CBCB – Czech Banking Credit Bureau, a.s. Software development, IT advisory, data processing, network administration databank services	Praha 4, Na Vítězné pláni 1719/4	1,200,000	20.00	20.00	none	20.00	none	Y
28985362	ENGIE REN s.r.o. Production and sale of electricity from the solar irradiation	Praha 4, Lhotecká 793/3	186,834,000	42.82	42.82	none	42.82	none	Y
25677888	ČSOB Asset Management, a.s., investment company <sup>3)</sup> Collective investment and asset management	Praha 5, Radlická 333/150	499,000,000	40.08	40.08	none	40.08	none	Y
45534306	ČSOB Pojišťovna, a.s., a member of the ČSOB holding <sup>4)</sup> Insurance company	Pardubice, Zelené předměstí, Masarykovo náměstí 1458	2,796,248,000	0.24	0.24	none	40.00	none	Y
27479714	ČSOB Pojišťovací servis, s.r.o., a member of the ČSOB holding Insurance brokerage	Pardubice, Zelené předměstí, Masarykovo náměstí 1458	400,000	0.24	none	0.24	0.00	ČSOB Pojišťovna	Y
45316619	IP Exit, a.s. <sup>5)</sup> – in bankruptcy No activity	Praha 1, Senovážné náměstí 32	13,382,866,400	85.63	71.29	14.34	85.63	ČSOB Advisory, ČSOB Pojišťovna	Y
63078104	Premiéra TV, a.s. No activity	Praha 8, Pod Hájkem 1	29,000,000	29.00	29.00	none	29.00	none	Y
26439395	První certifikační autorita, a.s. Certification services and administration	Praha 9-Libeň, Podvinný mlýn 2178/6	20,000,000	23.25	23.25	none	23.25	none	Y
Other companies where ČSOB has a share in registered capital / voting rights under 10%.									N

Prudential consolidation (Decree No. 163/2014 Coll.)

- 1) ID No. 99999999 – a foreign entity.
- 2) Shares in registered capital: ČSOB 59.79%, ČSOB Asset Management 4.33%, ČSOB Pojišťovna 35.88%; shares in voting rights: ČSOB 95.67%, ČSOB Asset Management 4.33%.
- 3) Shares in registered capital: ČSOB 40.08%, KBC Participations Renta C 59.92%; shares in voting rights: ČSOB 40.08%, KBC Participations Renta C 59.92%.
- 4) Shares in registered capital: ČSOB 0.24%, KBC Insurance 99.76%; shares in voting rights: ČSOB 40%, KBC Insurance 60%.
- 5) Shares in registered capital: ČSOB 71.29%, ČSOB Advisory 14.34%, ČSOB Pojišťovna 0.11%; shares in voting rights: ČSOB 71.29%, ČSOB Advisory 14.34%.

### Changes in 2016

ENGIE REN s.r.o. (CZ; ID No.: 28985362): The business name of company changed (the original business name COFELY REN, s.r.o.) – erased of an entry in the Register of Companies on 1 May 2016.

Visa Europe (CZ; ID No.: 99999999): dissolution of Visa Europe and merger to Visa Inc. on 28 June 2016.

Patria investiční společnost, a.s. (CZ; ID No.: 05154197): establishment of company on 9 June 2016. Entry in the Register of Companies of 9 June 2016.

Top-Pojištění.cz, s.r.o. (CZ; ID No.: 27388239): purchase of equity investments on 21 June 2016. Entry in the Register of Companies on 14 July 2016.

SousedecZ s.r.o. (CZ; ID No.: 02623111): purchase of equity investments Hypoteční banka, a.s. Entry in the Register of Companies on 5 February 2014.

### Changes in 2017

ČSOB Property fund, a.s. (CZ; ID No.: 27924068): "in liquidation" – entry to liquidation on 1 January 2017.

Merrion Properties s.r.o. (CZ; ID No.: 25617184): "in liquidation" – entry to liquidation on 1 January 2017.

## CORPORATE GOVERNANCE

### Managing and Supervisory Bodies

Corporate governance and administration of Československá obchodní banka, a. s. are based on the OECD principles and, while executing them, experience collected by the KBC Group, is extensively exploited. ČSOB professes principles formulated in the Code of Governance and seeks to observe them consistently in its day-to-day activities.

**ČSOB has the following bodies:** General Meeting, Board of Directors, Supervisory Board, and Audit Committee. The powers and activities of ČSOB's bodies are determined in the Articles of Association of ČSOB as approved by the General Meeting. The sole shareholder (KBC Bank NV) exercises the powers of ČSOB's General Meeting.

#### The Board of Directors in 2016

First Name and Surname	Position	Membership since	Current Term in Office since <sup>1)</sup>	ČSOB's Top Management <sup>4)</sup> Position and Area of Responsibility
<b>John Arthur Hollows</b>	Chairman <sup>2)</sup>	1. 5. 2014	1. 5. 2014	Chief Executive Officer
<b>Marek Ditz</b>	Member	1. 1. 2013	1. 1. 2013 <sup>5)</sup>	Senior Executive Officer, Specialised Banking and Insurance <sup>7)</sup>
<b>Petr Knapp</b>	Member	20. 5. 1996	21. 5. 2014 <sup>3)</sup>	Senior Executive Officer, Relationship Services
<b>Petr Hutla</b>	Member	27. 2. 2008	28. 2. 2013 <sup>6)</sup>	Senior Executive Officer, Retail
<b>Jiří Vévoda</b>	Member	8. 12. 2010	9. 12. 2015 <sup>3)</sup>	Senior Executive Officer, Finance Management
<b>Tomáš Kořínek</b>	Member	1. 1. 2015	1. 1. 2015	Senior Executive Officer, Group Risk Management

1) The term in office of the members lasts four years.

2) Chairman since 2 May 2014.

3) Elected to a new term in office.

4) In 2016, members of ČSOB's Top Management were identical with the members of the Board of Directors of ČSOB.

5) Elected to a new term in office since 2 January 2017.

6) Elected to a new term in office since 1 March 2017.

7) Senior Executive Officer of Transformation since 1 March 2017.

**For a description of areas of responsibility managed by ČSOB's Board of Directors (Top Management) as at 31 December 2016 please refer to ČSOB's Organisation Chart, page 64 of this Annual Report. Descriptions of work and decision-making processes are given in Corporate Governance chapter of this Annual Report, page 58.**

## The Supervisory Board in 2016

First Name and Surname	Position	Membership since	Current Term in Office since <sup>1)</sup>	Termination of Membership
<b>Pavel Kavánek</b>	Chairman <sup>2)</sup>	1. 5. 2014	1. 5. 2014	–
<b>Hendrik George Adolphe Gerard Soete</b>	Member	24. 2. 2007 <sup>3)</sup>	20. 6. 2012 <sup>4)</sup>	20. 6. 2016
<b>Franky Depickere</b>	Member	1. 6. 2014	1. 6. 2014	–
<b>Christine Van Rijsseghem</b>	Member	1. 6. 2014	1. 6. 2014	–
<b>Martin Jarolím</b>	Member	1. 1. 2015	1. 1. 2015	30. 6. 2016
<b>Willem Hueting</b>	Member	1. 7. 2016	1. 7. 2016	–
<b>Marc Wittemans</b>	Member	1. 10. 2016	1. 10. 2016	–

1) The term in office of the members lasts four years.

2) Chairman since 30 June 2014.

3) Co-opted.

4) Elected to a new term in office.

## The Audit Committee in 2016

First Name and Surname	Position		Membership since	Termination of Membership
<b>Petr Šobotník</b>	Chairman <sup>1)</sup> ; Independent member	Not a member of any ČSOB body	1. 2. 2011	–
<b>Ladislav Mejzlík</b>	Independent member	Not a member of any ČSOB body	27. 1. 2016	–
<b>Martin Jarolím</b>	Member <sup>2)</sup>	Member of ČSOB's Supervisory Board (from 1. 1. 2015 to 30. 6. 2016)	1. 6. 2014	30. 6. 2016
<b>Willem Hueting<sup>3)</sup></b>	Member	Member of ČSOB's Supervisory Board (since 1. 7. 2016)	1. 7. 2016	–
<b>Pavel Kavánek</b>	Member	Chairman of ČSOB's Supervisory Board (since 30. 6. 2014; member since 1. 5. 2014)	1. 6. 2014	27. 1. 2016

1) Chairman since 7 April 2016.

2) Chairman from 9 April 2015 to 7 April 2016.

3) Acting in KBC Group as the Senior General Manager, Group Communities (Business Unit International Markets).



## Changes in ČSOB's Managing and Supervisory Bodies in 2016

### KBC Bank as the sole shareholder of ČSOB in exercising the powers of the General Meeting decided as follows

#### On 27 January 2016

- Pavel Kavánek was removed from ČSOB's Audit Committee with effect from 27 January 2016.
- Ladislav Mejzlík was appointed a member of ČSOB's Audit Committee with effect from 27 January 2016.

#### On 29 June 2016

- Martin Jarolím was removed from ČSOB's Supervisory Board with effect from 30 June 2016.
- Martin Jarolím was removed from ČSOB's Audit Committee with effect from 30 June 2016.
- Willem Hueting was elected a member of ČSOB's Supervisory Board with effect from 1 July 2016.
- Willem Hueting was appointed a member of ČSOB's Audit Committee with effect from 1 July 2016.

#### On 30 September 2016

- Marc Wittemans was elected a member of ČSOB's Supervisory Board with effect from 1 October 2016.

#### On 6 December 2016

- Marek Ditz was re-elected as a member of ČSOB's Board of Directors for his second tenure with effect from 2 January 2017.
- Petr Hutla was re-elected as a member of ČSOB's Board of Directors for his third tenure with effect from 1 March 2017.

In addition Mr. Hendrik George Adolphe Gerard Soete ended his term in office (after 9 years) as member of the Supervisory Board of ČSOB; his term in office ended on 20 June 2016.

## Changes in ČSOB's Managing and Supervisory Bodies in 2017

#### On 18 January 2017

- Petr Šobotník was elected a member of ČSOB's Supervisory Board with effect from 1 February 2017.

#### On 27 February 2017

- Marcela Suchánková was elected a member of ČSOB's Board of Directors with effect from 1 March 2017 (Area of responsibility People and Communication).
- Jan Sadil was elected a member of ČSOB's Board of Directors with effect from 1 March 2017 (Area of responsibility Specialised Banking and Insurance).

## The Composition of ČSOB's Board of Directors since 1 March 2017:

John Arthur Hollows (Chairman), Marek Ditz, Petr Hutla, Petr Knapp, Jiří Vévoda, Tomáš Kořínek, Marcela Suchánková, Jan Sadil.

For a description of areas of responsibility managed by ČSOB's Board of Directors (Top Management) since 1 March 2017 please refer to ČSOB's Organization Chart, page 65 of this Annual Report. Abbreviated curriculum vitae of the members of the Board of Directors can be found of page 50.

## The Composition of ČSOB's Supervisory Board since 1 February 2017:

Pavel Kavánek (Chairman), Franky Depickere, Christine Van Rijsseghem, Willem Hueting, Marc Wittemans, Petr Šobotník.

## Conflict of Interests

*under Commission Regulation (EC) No 809/2004*

ČSOB hereby declares that it is not aware of any potential conflict of interests between any of the duties of any member of the Board of Directors, ČSOB's Top Management and the Supervisory Board to ČSOB and their private interests and / or other duties.

*ČSOB does not regard entering into banking transactions by the members of the Board of Directors of ČSOB, the members of ČSOB's Top Management and the members of the Supervisory Board of ČSOB under standard terms as a conflict of interests between the duties of these persons to ČSOB and their private interests and / or other duties.*

## The Business Address

of members of the Board of Directors, ČSOB's Top Management and the Supervisory Board is:

**Československá obchodní banka, a. s.**  
**Radlická 333/150**  
**150 57 Praha 5**  
**Česká republika**

## INTRODUCING MEMBERS OF MANAGING AND SUPERVISORY BODIES

### ČSOB's Board of Directors in 2016

#### JOHN ARTHUR HOLLOWS

*Born on 12 April 1956*

Chairman of the  
Board of Directors

He graduated from the Sidney Sussex College at the University in Cambridge with a degree in economics and law.

Upon graduation Mr. Hollows has followed a career in banking. He gained experience in the area of financial services at Barclays Bank in London and Taipei and at KBC in Hong Kong, Shanghai and Singapore. He held senior managerial positions in credit departments and in areas such as export finance, corporate and investment banking and treasury. He also focused on cost management. From August 2003 to April 2006, he was the Chief Executive Officer of K&H Bank (KBC Group) in Hungary. Between 2006 and 2009, Mr. Hollows served as the Senior General Manager of the Central and Eastern Europe Business Unit of the KBC Group. From September 2009 to April 2010, he was the CEO of KBC Group's Central and Eastern Europe and Russia Business Unit. Since September 2009 he has been a member of the Executive Committee of the KBC Group. From May 2010 to April 2014, he served as the Chief Risk Officer of the KBC Group. Between April 2006 and June 2009, Mr. Hollows was a member of ČSOB's Supervisory Board and the Chairman of its Audit Committee. Since 1 May 2014, he has been a member of the Board of Directors of ČSOB (and its Chairman since 2 May 2014). Since 1 May 2014, Mr. Hollows has been the member of the Executive Committee of the KBC Group responsible for the Business Unit Czech Republic.

*Membership in bodies of other companies:*

- Member of the Executive Committee of the KBC Group (Belgium)
- Member of the Board of Directors and member of the Executive Committee of KBC Bank (Belgium) and KBC Insurance (Belgium)

#### MAREK DITZ

*Born on 16 September 1972*

Member of the Board  
of Directors

Specialised Banking  
and Insurance

He graduated from the University of Economics, Prague and Swiss Banking School, Zurich.

Mr. Ditz has been working for ČSOB since 1994. He was appointed the Manager of the Specialised and Institutional Banking unit in 2005. He was appointed the Executive director of Corporate and Institutional Banking in 2010, where he was in charge of the distribution network of 10 regional branches providing service to corporate clients as well as for specialised financing, foreign trade and institutional banking which also caters to non-banking financial institutions, banks and selected public sector entities. Since 1 January 2013, Mr. Ditz has been a member of the Board of Directors. Between January 2013 and April 2014, he served as a member of ČSOB's Top Management as the Senior Executive Officer, Customer Relationships, and then as the Senior Executive Officer responsible for Investments & Markets (until 30 June 2014). From 1 July 2014 to 9 March 2015, he was a member of ČSOB's Top Management responsible for Insurance, Markets & Investments. From 10 March 2015 to 28 February 2017, he was responsible for Specialised Banking and Insurance. Since 1 March 2017, he has been responsible for Transformation area.

*Membership in bodies of other companies:*

- Chairman of the Supervisory Board in: Hypoteční banka (CZ) and ČSOB Advisory (CZ)
- Deputy Chairman of the Supervisory Board of ČMSS (CZ)
- Member of the Supervisory Board in: ČSOB Asset Management (CZ), Patria Online (CZ), Patria Finance (CZ) and Patria Corporate Finance (CZ)
- Member of the Audit Committee in: ČMSS (CZ) and ČSOB Pojišťovna (CZ)

**PETR KNAPP***Born on 7 May 1956*

Member of the Board of Directors

Relationship Services

He graduated from the University of Economics, Prague.

Mr. Knapp originally joined ČSOB in 1979. He worked in Teplotechna Praha as Deputy Managing Director from 1984 and later as Director of Foreign Operations. He returned to ČSOB in 1991 and was appointed Director of ČSOB Corporate Finance Department and later Director of the Credits Section. He has been a member of the Board of Directors and Senior Executive Officer of ČSOB since 1996. Between March 2005 and April 2014, Mr. Knapp served as a member of ČSOB's Top Management as the Senior Executive Officer, Corporate Banking and Financial Markets. Since 1 May 2014, he has been a member of ČSOB's Top Management responsible for Relationship Services.

*Membership in bodies of other companies:*

- Chairman of the Supervisory Board in: ČSOB Factoring (CZ) and ČSOB Leasing (CZ)
- Member of the Supervisory Board in: Patria Online (CZ), Patria Finance (CZ) and Patria Corporate Finance (CZ)
- Member of the Board of Directors of the Prague Economic Chamber (CZ)
- Member of the Board of Trustees of the University of Chemistry and Technology, Prague (CZ)

**PETR HUTLA***Born on 24 August 1959*

Member of the Board of Directors

Retail

He graduated from the Czech Technical University Prague, Faculty of Electrical Engineering.

Mr. Hutla worked for Tesla Pardubice between 1983 and 1993, as the Economic Associate Director of Tesla Pardubice – RSD from 1991. He has been working for ČSOB since 1993: first as the branch manager in Pardubice and the main branch manager in Hradec Králové, then as the main branch manager in Prague 1. Mr. Hutla then served as Senior Director, Corporate and Institutional Banking (between 2000 and 2005). He has worked as Senior Executive Officer since 2005: Personnel and Strategic Management (between 2005 and 2006), Human Resources and Transformation (between 2006 and 15 November 2009), Distribution (between 16 November 2009 and 31 December 2012). Since 27 February 2008, Mr. Hutla has been a member of the Board of Directors. From 14 January 2009 to 31 December 2011, he was also the head of KBC Global Services Czech Branch, organizational unit. Between January 2013 and June 2014, Mr. Hutla was a member of ČSOB's Top Management as the Senior Executive Officer, Specialized Banking and Insurance. From 1 July 2014 to 9 March 2015, he was a member of ČSOB's Top Management responsible for Convenient Retail Services and from 1 October 2014 to 9 March 2015, also responsible for Change Zone; since 10 March 2015, Mr. Hutla has been responsible for Retail (after the merger of these two management areas).

*Membership in bodies of other companies:*

- Chairman of the Supervisory Board of ČSOB Pojišťovna (CZ)
- Member of the Board of Directors in: the Czech Technical University in Prague (CTU; CZ), the Czech Transplant Foundation (CZ) and the Nadační fond Moderní léčba arytmií (endowment fund; CZ)

**JIRÍ VÉVODA***Born on 4 February 1977*

Member of the Board of Directors

Finance Management

He graduated from the Joint European Studies Programme at the Staffordshire University and the University of Economics, Prague.

From 2000 to 2004, Mr. Vévoda worked for GE Capital in the Czech Republic, Ireland, Finland and Sweden. From 2004 to 2010, he worked for McKinsey & Company. Since 1 May 2010, he has been a member of ČSOB's Top Management. As of 8 December 2010, he has become a member of ČSOB's Board of Directors. Firstly Mr. Vévoda acted as the Senior Executive Officer responsible for HR and Transformation and afterwards he was responsible for Products and Staff Functions. Between January 2013 and June 2014, Mr. Vévoda acted as the Chief Risk Officer. Since 1 July 2014, he has been appointed as the Chief Finance Officer.

*Membership in bodies of other companies:*

- Member of the Supervisory Board in: Hypoteční banka (CZ), ČSOB Leasing (CZ) and ČMSS (CZ)

**TOMÁŠ KOŘÍNEK***Born on 10 June 1967*

Member of the Board of Directors

Group Risk Management

He graduated from the Czech Technical University Prague, Faculty of Electrical Engineering (Economy and Management).

Upon his graduation Tomáš Kořínek held senior management positions at several financial institutions in the Czech Republic. Before joining ČSOB, he worked as a member of Volksbank CZ Board of Directors responsible for risk management, finance and operations. He has been working for ČSOB since April 2009; between May 2010 and October 2013, as a Director of Risk Management Department and from November 2013 to 31 December 2014, as a Executive Director responsible for Group Risk Management. Since 1 January 2015, he has been a member of ČSOB's Board of Directors responsible for Group Risk Management (CRO).

*Membership in bodies of other companies:*

- Member of the Audit Committee in: Hypoteční banka (CZ), ČMSS (CZ) and ČSOB Pojišťovna (CZ)
- Member of the Supervisory Board in ČSOB Pojišťovna (CZ)

**New members of Board of Directors as of 1 March 2017****MARCELA SUCHÁNKOVÁ***Born on 3 January 1971*

Member of the Board of Directors

People and Communication

She graduated from University of Economics, Prague and has an MBA diploma from US Business School Prague (Rochester Institute of Technology).

Ms. Suchánková started her professional career in consulting and public relationship area. She joined ČSOB Communication department in 1997. In 1999, she moved to retail banking, where she managed various projects and departments (product development, direct marketing, savings and investments). From 2013 to 2015, Ms. Suchánková was a member of ČSOB Pension Company Board of Directors responsible for business and later became the Chairman of the Board and CEO of ČSOB Pension Company. From 2015 to 2016, she hold ČSOB Human Resources General Manager position. As of 1 March 2017, she has been appointed as a member of ČSOB's Board of Directors responsible area of People and Communication division.

*Membership in bodies of other companies:*

- None

**JAN SADIL***Born on 16 February 1969*

Member of the Board of Directors

Specialized Banking and Insurance

He graduated from the Civil Engineering Faculty of the Czech Technical University in Prague and gained his PhD degree at the Institute of Forensic Engineering of University of Technology in Brno.

Mr. Sadil started his banking career in Komerční banka, a.s. in 1995. In 2000, he was appointed as the manager responsible for private individuals loans division. In 2001, he joined Českomoravská hypoteční banka, a.s. (currently Hypoteční banka, a.s.) as a member of the Board of Directors responsible for sales and marketing. Since the end of 2003 till March 2017, he hold the position of Chairman of the Board of Directors and the CEO of Hypoteční banka. As of 1 March 2017, he has been appointed as a member of ČSOB's Board of Directors responsible for Specialised Banking and Insurance.

*Membership in bodies of other companies:*

- Member of the Supervisory Board in: Association for Real Estate Market Development (CZ), Czech Banking Association (CZ) and Centrum Paraple (CZ)
- Chairman of the Supervisory Board Via Cordata (CZ)

## ČSOB's Supervisory Board

### PAVEL KAVÁNEK

Born on 8 December 1948

Chairman of the Supervisory Board

He graduated from the University of Economics, Prague and The Pew Economic Freedom Fellowship at Georgetown University.

Between 1972 and April 2014, Mr. Kavánek worked for ČSOB. From 1990 to April 2014, he was a member of the Board of Directors of ČSOB. Between 1993 and 30 April 2014, he served as the Chairman of the Board of Directors of ČSOB and the CEO. From 1 January 2013 to 30 April 2014, Mr. Kavánek was a member of the Executive Committee of the KBC Group responsible for the Business Unit Czech Republic. Since September 2015, Mr. Kavánek has been an investor and a non-executive director in Decipher Lab Ltd. (GB).

Since 1 May 2014, he has been a member of ČSOB's Supervisory Board (and its Chairman since 30 June 2014).

From 1 June 2014 to 27 January 2016, he was a member of ČSOB's Audit Committee.

*Membership in bodies of other companies:*

- President of the Executive Board of the Czech Banking Association (CZ)
- Member of the Board of Trustees of the Aspen Institute Prague (CZ)

### FRANKY DEPICKERE

Born on 26 January 1959

Member of the Supervisory Board

Franky Depickere studied commercial and financial sciences at the University of Antwerp (UFSIA; Belgium), and obtained a Master's degree in company financial management from the VLEKHO Business School (Belgium).

Following a short period at Gemeentekrediet bank, in 1982 Franky Depickere joined the CERA group, where he spent more than 17 years. Among other things he was an internal audit inspector at CERA Bank, financial director of CERA Lease Factors Autolease, chairman of the board of Nédée België-Luxemburg, a subsidiary of CERA Bank, a member of the Management Committee of CERA Investment Bank, and finally a Managing Director at KBC Securities. In 1999 he became managing director and chairman of the Management Committee of F. van Lanschot Bankiers België, as well as group director of F. van Lanschot Bankiers Nederland. From 2005 he was also a member of the Strategic Committee of F. van Lanschot Bankiers Nederland. Since 15 September 2006, he has been a member of Cera's Day-to-Day Management Committee and Managing Director of Cera Société de gestion and Almancora Société de gestion. Franky Depickere is a member of the Board of Directors of the KBC Group (a non-executive director).

Since 1 June 2014, he has been a member of ČSOB's Supervisory Board.

*Membership in bodies of other companies:*

- Member of the Board of Directors (a non-executive director) in: KBC Group (Belgium), KBC Bank (Belgium), KBC Assurances (Belgium) and CBC Banque (Belgium)
- Chairman of the Risk and Compliance Committee in: KBC Group (Belgium), KBC Bank (Belgium) and KBC Assurances (Belgium)
- Member of the Nomination Committee of the KBC Group (Belgium)
- Member of the Nomination Committee and the Remuneration Committee of CBC Banque (Belgium)
- Vice-Chairman of the Supervisory Board and Chairman of the Audit Committee of Euro Pool System International (the Netherlands)
- Chairman of the Board of Directors in: the Flanders Business School (Belgium) and the International Raiffeisen Union (Germany)
- Member of the Supervisory Board of University of Leuven – KULAK (Belgium)

**CHRISTINE VAN  
RIJSSEGHM***Born on 24 October 1962*Member of the  
Supervisory Board

She graduated in 1985 from the Faculty of Law at the University of Ghent (Belgium). Subsequently she completed an MBA in Financial Sciences at Vlerick Management School in Ghent (Belgium).

Ms. Van Rijseghem started her career at KBC (formerly Kredietbank) in 1987 at the Central Foreign Entities Department. Initially she was responsible for risk management and controlling and international acquisition strategy, and later on became head of that department. In 1994 she was appointed Head of the Credit Department of KBC's Irish subsidiary, Irish Intercontinental Bank. In 1996, she became CEO of KBC France and in 1999 of KBC's London branch. From 2000 to 2003, she was Senior General Manager of the Securities & Derivatives Processing Directorate of KBC Group. From 2003 to 30 April 2014, she was Senior General Manager of KBC Group Finance. Since 1 May 2014, Christine Van Rijseghem has been a member of the Executive Committee of the KBC Group and KBC Group Chief Risk Officer.

Since 1 June 2014, she has been a member of ČSOB's Supervisory Board.

*Membership in bodies of other companies:*

- Member of the Executive Committee of the KBC Group (Belgium)
- Chairman of the Risk and Compliance Committee and member of the Audit Committee of ČSOB (SK)
- Member of the Board of Directors and Chairman of the Risk Committee of K&H Bank (Hungary)
- Member of the Supervisory Board, Chairman of the Risk and Compliance Committee and member of the Audit Committee of CIBANK (Bulgaria)
- Member of the Board of Directors, Chairman of the Risk Committee and member of the Remuneration and Nomination Committee of Bank Ireland (Ireland)

**WILLEM HUETING***Born on 16 February 1962*Member of the  
Supervisory Board

He obtained certificates in Organization and Marketing at the Open University Zwolle in the Netherlands.

Mr. Hueting has more than 30 years experience in banking and insurance industry. He gained his experience in ABN AMRO in life insurance, investment funds, private banking, marketing, product and project management where he held several positions in the Netherlands and in Hungary.

From 2001 to 2006, he was appointed as the member of the Board of Directors in Raiffeisen International Bank Czech Republic, responsible for distribution network, marketing and quality, central project office and overall reorganisation programme. Mr. Hueting joined the KBC Group in 2007 as a member of the Board KBC Consumer Finance International. After this he worked also as a Chief Executive Officer in ČSOB Poistovňa (SK) and CEO Consumer Finance International KBC Group. Since May 2016, Mr. Hueting has been appointed as the Senior General Manager, Group Communities Banking (Business Unit International Markets)&Consumer Finance in KBC Group.

Since 1 July 2016, he has been a Member of ČSOB's Supervisory Board, Member of ČSOB's Audit Committee, Risk and Compliance Committee and Nomination and Remuneration Committee.

*Membership in bodies of other companies:*

- Member of the Board of Directors; Member of the Risk and Compliance Committee; Member of the Nomination and Remuneration Committee in K&H Bank (Hungary)
- Member of the Supervisory Board; Chairman of the Audit Committee; Member of the Risk and Compliance Committee; Member of the Nomination and Remuneration Committee in CIBANK (Bulgaria)
- Member of the Board of Directors; Member of the Audit Committee; Member of the Risk and Compliance Committee (Deputy Chairman of the Risk and Compliance Committee); Member of the Corporate Governance Committee; Member of the Non Equity Capital and Debt and Related Party Lending Committee in KBC Bank Ireland (Ireland)



**MARC WITTEMANS***Born on 8 February 1957*Member of the  
Supervisory Board

Mr. Wittemans graduated in 1980 from Catholic University of Leuven, Belgium (Applied Economics). After he graduated also from Institute of Fiscal Sciences Brussels (Taxation; 1981) and Institute of Actuarial Sciences at Catholic University of Leuven, Belgium (1983). He continued his education via various trainings and seminars focused on finance, banking, insurance, accounting, tax and legal topics organized mainly Catholic University of Louvain.

Mr. Wittemans started his professional career as an internal auditor in the holding company MRBB Group. He held several consulting and managerial positions in companies of MRBB, Acerta and KBC Group mainly in areas of finance, tax, audit, legal and governance. From 1982 to 2009 he worked also as a Professor Auditing in the academic master program at Vlekho, associated with the Catholic University of Leuven. As of 2008, he has been appointed as the CEO of MRBB (Belgium).

Since October 2016, Marc Wittemans has been a member of ČSOB's Supervisory Board.

*Membership in bodies of other companies:*

- Member of the Board of Directors in: KBC Group, KBC Bank and KBC Insurance, Acerta Group, SBB Group (Belgium)
- Chairman of the Audit Committee in: KBC Group, KBC Bank and KBC Insurance (Belgium)
- Member of the Risk and Compliance Committee of KBC Group (Belgium)
- Member of the Audit Committee and Member of the Strategic Committee of Acerta Group (Belgium)
- Member of the Audit Committee of SBB Group (Belgium)
- Member of the Investment Committee of MRBB and of Agri Investment Fund (Belgium)

**ČSOB's Audit Committee****PETR ŠOBOTNÍK***Born on 16 May 1954*Independent  
chairman of the Audit  
Committee

He graduated from the University of Economics, Prague.

Between 1983 and 1991, Mr. Šobotník acted as a chief accountant in corporations as well as government bodies. In 1991, he joined the audit firm Coopers & Lybrand; he became a partner for audit in 1995. After the merger of the audit firms, he served as the Lead Audit Partner at PricewaterhouseCoopers from 1998 to 2002. He then worked in various top management positions at PwC until June 2010. From 2007 to 2014, he was the President of the Czech Chamber of Auditors. At present, Mr. Šobotník is an independent consultant (Šobotník & Partners).

Since 1 February 2011, he has been an independent member of ČSOB's Audit Committee (and its Chairman since 7 April 2016).

Since 1 February 2017, he has been a member of ČSOB's Supervisory Board.

*Membership in bodies of other companies:*

- Representative of the Czech Republic in FEE – Ethics Working Party (since 2004)
- Member of the Supervisory Committee of the Czech Chamber of Auditors (since November 2014 till March 2016)
- Chairman of the Audit Committee of Český Aeroholding (since February 2014; CZ) and ČEPRO (since January 2016; CZ)
- Member of the Audit Committee of ČSOB Penzijní společnost (since March 2016; CZ)
- Member of the Supervisory Board of the Nadační fond Českého rozhlasu (Czech Radio Endowment Fund; CZ)



**LADISLAV MEJZLÍK***Born on 1 May 1961*Independent  
member of the Audit  
Committee

He graduated from the University of Economics in Prague (UEP).

Since 1984 Ladislav Mejzlík is working at the Faculty of Finance (UEP), where he was initially assistant and then deputy to the Head of the Department of Financial Accounting and Auditing between 2006 and 2014. In 2014 was elected as the dean of the Faculty of Finance and Accounting. Mr. Mejzlík was licensed as an auditor in 1993 and he was elected as a member of the Executive Board of Chamber of Auditors of the Czech Republic (CA CR) in 2007. In the years 2010–2014 he was elected twice as the First Vice President of CA CR.

Mr. Mejzlík is representing the Faculty of Finance and Accounting of UEP in the National Accounting Council since 2004, and in 2004 he was elected as the National Representative for the Czech Republic in the European Accounting Association Board of Representatives. Mr. Mejzlík is professionally focused on the use of information and communication technology in accounting and auditing, and on the regulation and harmonization of accounting internationally, especially on the implementation of IFRS.

Since 27 January 2016, he has been an independent member of ČSOB's Audit Committee.

*Membership in bodies of other companies:*

- Chairman of the Audit Committee of ČSOB Insurance, member of the Supervisory Board and Chairman of the Audit Committee of ČSOB Slovakia (since 2016)
- Member of the scientific committee at the UEP, the Faculty of Finance of UEP and the Faculty of Economic Informatics of Economic University in Bratislava
- Licenced statutory auditor and member of the Chamber of Auditors of the Czech Republic (since 1993)
- Member of the European Accounting Association (since 1994) and the American Accounting Association (since 2005)

**Termination of Membership in ČSOB's Managing and Supervisory Bodies in 2016****HENDRIK SOETE***Born on 9 November 1950*Member of the  
Supervisory Board  
till 20 June 2016

He holds M.Sc. and Ph.D. degrees in Agricultural Sciences from the Catholic University in Leuven (Belgium).

Mr. Soete originally worked in production management at Procter & Gamble and at Lacsoons Dairy in Belgium. Between 1983 and 1994, he held several management positions, as well as that of managing director, with Borden Inc., in the U.K. and in Germany. After his return to Belgium, he headed two food companies before joining the AVEVE Group in 1999. He was the Chairman of the Board of Directors of the AVEVE Group. He also served as a member of the Board of Directors of the MRBB, the Financial Holding of Boerenbond (Belgium), the CEO of the Agri Investment Fund of Boerenbond (Belgium) and the President of Intercoop Europe (Switzerland). Mr. Soete was the CEO of the AVEVE Group from May 2007 till June 2016.

From 24 February 2007 to 20 June 2016, he has been a member of ČSOB's Supervisory Board.

*Membership in bodies of other companies:*

- Member of the Board of Directors of Intercoop Europe (Switzerland) till June 2016.

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**MARTIN JAROLÍM***Born on 16 March 1972*

Member of the  
Supervisory Board  
till 30 June 2016

He graduated from the Charles University in Prague, Mathematics and Physics Department, where he studied from 1990 to 1995 specializing in Optimisation and Mathematical Economics, and then from 1995 to 2000 studied at Charles University in Prague, Centre for Economic Research and Graduate Education (CERGE-EI), – Ph.D. with the thesis Foreign Direct Investment and Foreign Trade. He has also attended various specialist and managerial courses.

Martin Jarolím has worked at ČSOB since 2000 in various specialized and management positions mainly in retail; from 2011 as Executive Director of ČSOB Retail Branch Network. Since February 2014 till April 2016, he worked as the Senior General Manager, Business Unit Core Communities Banking & International Markets in the KBC Group. In May 2016 Mr. Jarolím has been appointed as the member of the Executive Committee in K&H Bank Hungary responsible for Retail.

From 1 January 2015 to 30 June 2016, he has been a member of ČSOB's Supervisory Board.

From 1 June 2014 to 30 June 2016, he has been a member of ČSOB's Audit Committee (and he was its Chairman from 9 April 2015 to 7 April 2016).

*Membership in bodies in other companies:*

- Member of the Board of Directors (a non-executive director) in: K&H Bank (Hungary) till June 2016 and KBC Bank Ireland (Ireland) till May 2016
  - Member of the Supervisory Board in: ČSOB (SK) and CIBANK (Bulgaria) till August 2016
-

## Corporate Governance Policy

Československá obchodní banka, a. s., voluntarily meets and complies with the corporate governance guidelines set out in the Corporate Governance Code based on the OECD Principles.

The **Corporate Governance Code of ČSOB**, adopted by ČSOB's Board of Directors in 2012, defines the role of key bodies and sets basic rules of the Bank's governance in compliance with the Czech law and in line with internationally accepted practice. ČSOB's Corporate Governance Code is available in the department of the CEO.

Effective as from October 2012, the **Anti-Corruption Programme Policy of ČSOB** includes the principle of zero tolerance for bribery and corrupt practices. By issuing and introducing this programme, ČSOB formalized its principles and attitudes nurtured by ČSOB on a continuous and long-term basis. Compliant with the Code of Ethics, this regulation was issued to show to both the public and our employees that corrupt practices or other unethical conduct is and will not be tolerated in ČSOB.

Československá obchodní banka, a. s. has the following bodies: General Meeting, Board of Directors, Supervisory Board, and Audit Committee.

**The powers and activities of ČSOB's bodies are determined in the Articles of Association of ČSOB** as approved by the General Meeting.

## General Meeting

**The General Meeting of shareholders is the supreme body of ČSOB.** The General Meeting is equipped with a standard scope of powers as set out in the applicable laws. Among other things, the General meeting takes decisions on matters such as changes in the composition of the ČSOB's bodies, or amendments to the Articles of Association of ČSOB, or changes in the registered capital. The General Meeting also approves financial statements.

**The sole shareholder (KBC Bank NV) exercises the powers of ČSOB's General Meeting.** Resolutions are always in writing; a notarial deed is required in cases stipulated by the applicable laws. Where an approval is required by the law, draft resolutions are submitted to the sole shareholder by the Board of Directors. ČSOB's Board of Directors and ČSOB's Supervisory Board are notified of resolutions adopted by the sole shareholder in writing by the delivery of a written notice.

## Board of Directors

The Board of Directors of Československá obchodní banka, a. s. performs its tasks within the framework of competencies defined for the statutory body by legal regulations, the Articles of Association of ČSOB and relevant basic management documents of the company.

**The members of the Board of Directors are elected by the company's General Meeting** provided they comply with other requirements stipulated by the Banking Act. In compliance therewith, ČSOB's Board of Directors has a full-scale executive composition. ČSOB's shareholder and clients receive regular reports containing the required range of relevant data on the members of the Board of Directors and their professional and personal qualifications enabling them to duly execute their duties.

**At the end of 2016, ČSOB's Board of Directors had six members and worked in the following composition:** John Arthur Hollows (Chairman), Petr Hutla, Petr Knapp, Jiří Vévoda, Marek Ditz and Tomáš Kořínek.

*Personnel changes in ČSOB's Board of Directors during the year 2016 are described in the chapter Managing and Supervisory Bodies.*

**The Board of Directors meets regularly, usually once a week**, and follows a fixed agenda based on the strategic schedule of main topics and other documents of more operational nature submitted for discussion individually by the Board members. The members of the Board of Directors receive timely information and make their decisions on the basis of these duly processed documents in accordance with the rules of procedure of the Board of Directors. Discussions of the statutory body are attended by the Corporate Secretary of the Board of Directors who is responsible for preparing the meetings and taking their minutes. The Board of Directors has quorum if more than half of its members are present at the meeting. Any decision shall receive the votes of a majority of all members of the Board of Directors to be adopted.

**The Board of Directors establishes expert committees to discuss specific agendas.** Considering the importance of topics covered by the committees with company-wide scope of authority, a member of the Board of Directors primarily responsible for its activities usually presides over each committee. Should the responsible member of the Board of Directors be unable to take part in a committee meeting, such responsible member is substituted by a formally appointed deputy (usually another member of the Board of Directors). This approach makes it possible to achieve continuity of the consistent follow-up process focused on the committee's decision-making and to keep the Board of Directors directly informed. Depending on their roles and responsibilities, all ČSOB's units covering the subject matter are made involved in discussions and take part in committee meetings. This is why the head of such involved unit is authorized to take part and represent his / her unit in committee meetings. In his or her absence, committee meetings are attended by his or her deputy or another appointed employee unless forbidden by the applicable rule of procedure. Committee meetings are governed by the committee's rules of procedure.

## Board of Directors Committees

### Risk and Capital Oversight Committee (RCOC)

The Committee aims to support ČSOB's Board of Directors in the field of risk and capital management of the ČSOB group.

Chairman of the Committee: Tomáš Kořínek

### Credit Sanctioning Committee (CSC)

The Committee decides approvals / non-approvals of credit exposure of the ČSOB group.

Chairman of the Committee: Jiří Vévoda

### Enterprise Architecture Board (EAB)

The Committee manages and monitors the project portfolio from strategic, time and budget perspective. At the same time, the Committee decides about concepts and processes of business and IT architecture.

Chairman of the Committee: John Arthur Hollows

### Public Affairs Committee (PAC)

The Committee intends to promote the establishment and implementation of business and strategic initiatives and projects reflecting own needs or external influences and aims to achieve the business and strategic objectives of the Bank or the companies associated in the ČSOB group.

Chairman of the Committee: Petr Hutla

## ČSOB Corporate Social Responsibility Committee (CSRC)

The Committee defines the strategy of corporate social responsibility (CSR) and how it interlinks with the strategy of ČSOB, sets the direction in various areas of CSR and addresses inputs suggested and escalated from the Philanthropy Committee.

Chairman of the Committee: John Arthur Hollows

## Crisis Committee (CRC)

The goal is to be efficient in solving crisis situations that, if unaddressed, would adversely affect the operations of the whole Bank, or the ČSOB group, as the case may be.

Chairman of the Committee: John Arthur Hollows

## Other Bodies

### EXCO – Executive Committee Relationship Services

The purpose of the Committee is to ensure implementation of business and strategic initiatives and customer value proposition for corporate banking, SME and private banking in accordance with the powers delegated by ČSOB's Board of Directors and the ČSOB group's strategic plan.

### EXCO – Executive Committee for Retail Clients

The aim of the Committee is to review financial and business performance of Retail division in line with the plan, adherence to risk and compliance controls, and delivery of strategic and business initiatives in accordance with the powers delegated by ČSOB's Board of Directors, the ČSOB group strategic plan and Retail transformation roadmap.

### EXCO – Investments and Financial Markets

The Committee works as a joint platform composed of representatives of Financial Markets department, ČSOB Asset Management, ČSOB Penzijní společnost, Patria group and ČSOB Advisory. The main objective of the body is to coordinate the actions of these business units, especially in the areas of intersection of their activities, looking for new joint business opportunities and exchange of experiences in accordance with the powers delegated by ČSOB's Board of Directors and ČSOB group strategic plan.

## Supervisory Board

The Supervisory Board of Československá obchodní banka, a. s. supervises performance of tasks by the Board of Directors and discharge of the Bank's business activities. The members of the Supervisory Board shall be elected and removed by the General Meeting.

**At the end of 2016, ČSOB's Supervisory Board had five members and worked in the following composition:** Pavel Kavánek (Chairman), Christine Van Rijseghem, Franky Depickere, Marc Wittemans and Willem Hueting.

*Personnel changes in ČSOB's Supervisory Board during the year 2016 are described in the chapter Managing and Supervisory Bodies.*

In compliance with its plan of work, the Supervisory Board held **four meetings in 2016** where it discussed issues falling under its responsibility according to the Articles of Association of ČSOB. Reading materials for meetings of the Supervisory Board were prepared and delivered well in advance for the members of the Supervisory Board to have enough time to study them. Meetings of the Supervisory Board are also regularly attended by the members of the Board of Directors who personally present submitted materials. In compliance with its powers and based on the Audit Committee recommendation, the Supervisory Board selects an external auditor prior the

official appointment by the General Meeting of shareholders. The auditor attends all meetings of the Audit Committee, thus providing an independent, comprehensive and qualified opinion of whether ČSOB's financial statements reflect ČSOB's situation and performance correctly in all material respects. Pursuant to the Rules of Procedure of the Supervisory Board, administrative and organizational support is provided by the Corporate Secretary, who is responsible for taking the minutes of the meetings. Constitution of a quorum and majority necessary to adopt a decision follow the same principles as in case of the Board of Directors. Supervisory Board meetings are governed by the Articles of Association of ČSOB and by its rules of procedure.

## Supervisory Board Committees

The Supervisory Board, like as the Board of Directors, may establish advisory committees and other initiative committees to ensure its activities, either on the basis of legal regulations or in accordance with the Articles of Association of ČSOB. ČSOB's Supervisory Board established the Nomination and Remuneration Committee for remuneration, nomination and personal issues. Another advisory committee is the Risk and Compliance Committee.

### Nomination and Remuneration Committee

The Nomination and Remuneration Committee submits recommendations to the Supervisory Board as to the election of suitable candidates to the position of member(s) of ČSOB's Board of Directors and member(s) of statutory bodies of other entities controlled by ČSOB ("Controlled Subsidiaries"), submits recommendations to the Supervisory Board as to removal of current member(s) of the ČSOB Board of Directors and member(s) of statutory bodies of the Controlled Subsidiaries. The Nomination and Remuneration Committee also proposes a remuneration policy for the members of ČSOB's Board of Directors and member(s) of statutory bodies of the Controlled Subsidiaries including fixed as well as variable parts, submits proposals to ČSOB's Supervisory Board with respect to appointment to offices in committees of the Supervisory Board and recommendations to the Supervisory Board as to principles of remuneration of the head of the internal audit. The members of the Committee are regularly informed about changes and rotations of key identified employees and their remuneration.

**In 2016, the Nomination and Remuneration Committee was composed of the following members** (all of whom were members of ČSOB's Supervisory Board): Christine Van Rijsseghem, Martin Jarolím (till 30 June 2016), Pavel Kavánek and Willem Hueting (since 1 July 2016).

The Nomination and Remuneration Committee held **four meetings in 2016**.

### Risk and Compliance Committee

The Risk and Compliance Committee was established in 2014 by separation from the Audit Committee in compliance with the regulatory requirements. Its authority and responsibilities are determined by the Articles of Association of ČSOB and by the statutes of Risk and Compliance Committee. In particular, the Risk and Compliance Committee advises the Supervisory Body on the institution's overall current and future risk profile, appetite and risk strategy (including compliance risks). Risk and Compliance Committee reviews whether prices of liabilities and assets offered to clients take fully into account the Company's business model and risk strategy. Assists in the establishment of sound remuneration policies and practices, the risk committee shall, without prejudice to the tasks of the remuneration committee, examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings. The Committee supervises the proper functioning of Compliance and Risk Management departments.

The Risk and Compliance Committee members are elected by the Supervisory Board based on their expertise that is required to perform their duties in a professional manner. Particularly the Chairman and eventually other members of ČSOB's Board of Directors, the External Auditor and heads of ČSOB's departments – Compliance, Internal Audit and Legal participate as permanent guests in all meetings. Furthermore, some line managers or other employees who can provide

the Risk and Compliance Committee with relevant information can be invited to attend any meeting. Their participation is limited to the relevant agenda topics. Constitution of a quorum of the Risk and Compliance Committee and majority necessary to adopt a decision follow the same principles as in case of the Board of Directors.

**In 2016, the Risk and Compliance Committee worked in the following composition:** Christine Van Rijsseghem (Chairman), Martin Jarolím (till 30 June 2016), Pavel Kavánek, Willem Hueting (since 3 October 2016) and Petr Šobotník (independent Chairman of ČSOB's Audit Committee).

The Risk and Compliance Committee held **four meetings in 2016**.

## Audit Committee

The authority and responsibilities of **ČSOB's Audit Committee** are determined by the Articles of Association of ČSOB and the Audit Committee's Rules of Procedure. In particular, the Audit Committee monitors the compilation of the financial statement and the process of mandatory audit, supervises and monitors the quality of internal control, the work of internal audit and financial reporting. The Audit Committee recommends a statutory auditor, examines the adequacy of the auditor's independence and providing of additional services.

The Audit Committee has 3 members. The Audit Committee members are elected by the General Meeting from among the members of the Supervisory Board or third parties based on their expertise that is required to perform their control tasks in a professional manner. The Chairman and relevant members of ČSOB's Board of Directors, the External Auditor, heads of ČSOB's departments – Compliance, Internal Audit and Legal and head of KBC Internal Audit participate as permanent guests in Audit Committee's meetings. Furthermore, some line managers or other employees who can provide the Audit Committee with relevant information can be invited to attend any meeting. Their participation is limited to the relevant agenda topics. Constitution of a quorum of the Audit Committee and majority necessary to adopt a decision follow the same principles as in case of the Board of Directors.

**In 2016, the Audit Committee worked in the following composition:** Petr Šobotník (independent Chairman since 7 April 2016), Martin Jarolím (Chairman till 7 April 2016, member till 30 June 2016), Ladislav Mejzlík (independent member since 27 January 2016), Willem Hueting (member since 1 July 2016) and Pavel Kavánek (member till 27 January 2016).

The Audit Committee held **four meetings in 2016**.

*Personnel changes in ČSOB's Audit Committee during the year 2016 are described in the chapter Managing and Supervisory Bodies.*



## Internal Control Mechanisms to Minimize Financial Reporting Process Risks

**A number of tools in several areas are used to ensure true and fair representation of transaction in the company's accounting records and correct financial statements presentation. There are both automated and manual checks incorporated in the entire process starting with the transaction registration in the company systems up to financial statements preparation.**

Balances of all General Ledger accounts are subject to regular, at least monthly internal checks. The appointed person in charge, so-called Account Manager, performs logical and specific checks related to the General Ledger account balance consisting e.g. of reconciliation of data in support systems or non-accounting registers with the balances in the General Ledger, monitoring the development of the account balance, monitoring the occurrence of unusual transactions, manual entries in accounts with automatic accounting etc. Control procedures are set up to minimize the risk of accounting errors. Findings of accounting errors are listed centrally and relevant corrections are monitored. The adequacy and effectiveness of the accounting examinations are assessed on a regular basis. Findings are reported to the Internal Audit and Operational Risk Management on a semi-annual basis.

The internal control system also includes internal regulations determining authorities assumed by each staff member making entries in the accounting books in order to duly segregate responsibilities within the document flow. Control procedures are integrated to accounting systems including the "four eye" check and access right authentication. The risk of unauthorised entry is minimized by defining the persons who can make a predefined scope of transactions and persons authorised to give approvals.

Accounting procedures and valuation rules for assets and liabilities including rules for provisions and allowances are defined within internal regulations prepared in accordance with the legal requirements and international financial reporting standards. Monitoring of compliance with the requirements and incorporation of changes is provided by Accounting Methodology in cooperation with the units concerned. Applicable accounting policies, e.g. rules for valuation financial assets or principles of creation of allowances and provisions, are described in Note 2 to the Separate Financial Statement for the year 2016 prepared in accordance with EU IFRS and in Note 2 to the Consolidated Financial Statement for the year 2016 prepared in accordance with EU IFRS.

Control mechanisms are extended based on recommendations from internal audit, or based on outcomes of the risk assessment reviews organized as a part of the operational risk management, please refer to Note 38.5 to the Separate Financial Statement for the year 2016 prepared in accordance with EU IFRS and to Note 40.5 to the Consolidated Financial Statement for the year 2016 prepared in accordance with EU IFRS.

Majority of financial statements is generated automatically using the data from the central data warehouse, reconciled to the General Ledger balances.

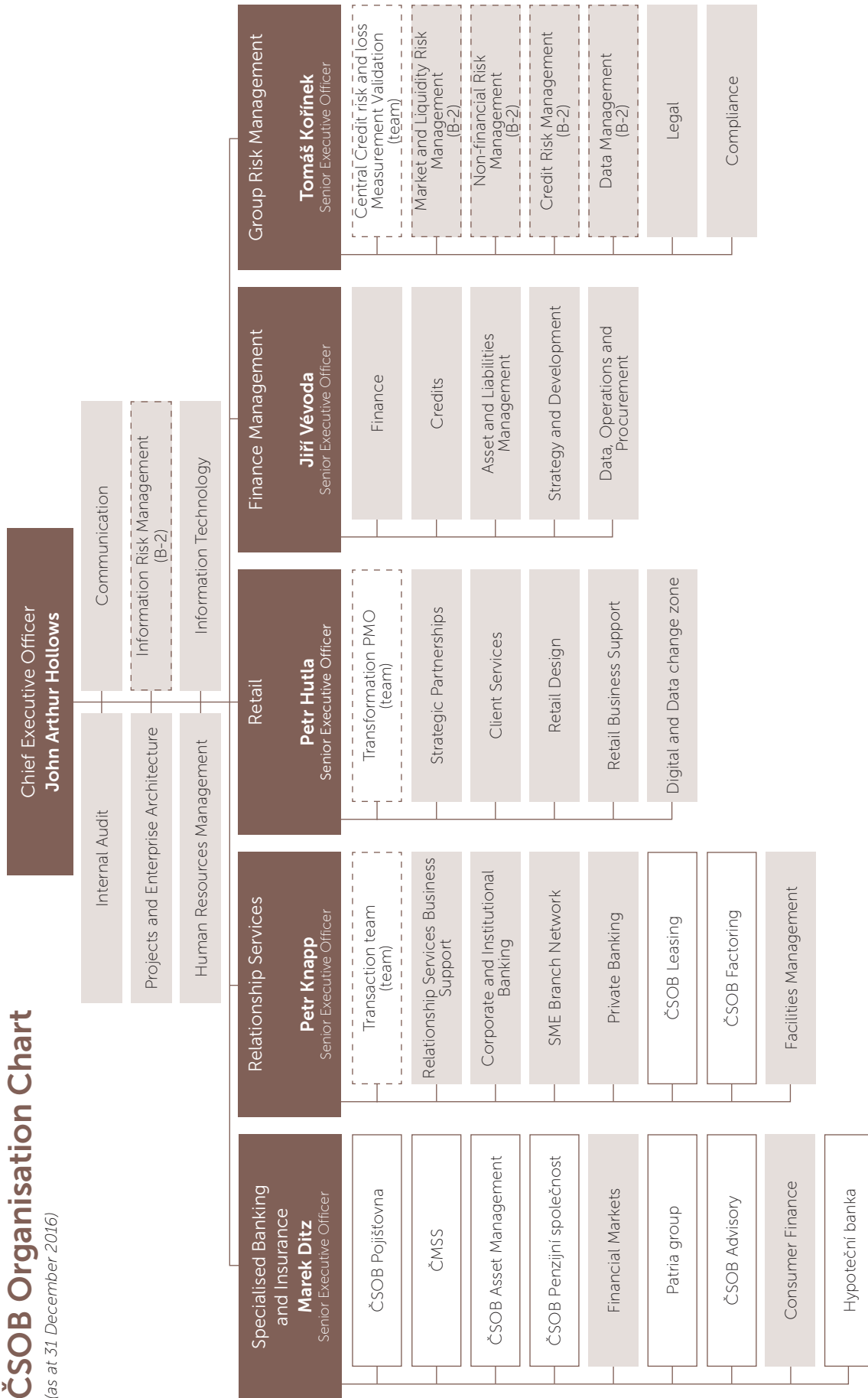
Consolidated financial statements are submitted to ČSOB's Supervisory Board regularly and both consolidated and separate financial statements are subject to external audit review.

The effectiveness and efficiency of internal controls is evaluated by internal auditors. Report on financial results is submitted to ČSOB's Audit Committee quarterly.



# ČSOB Organisation Chart

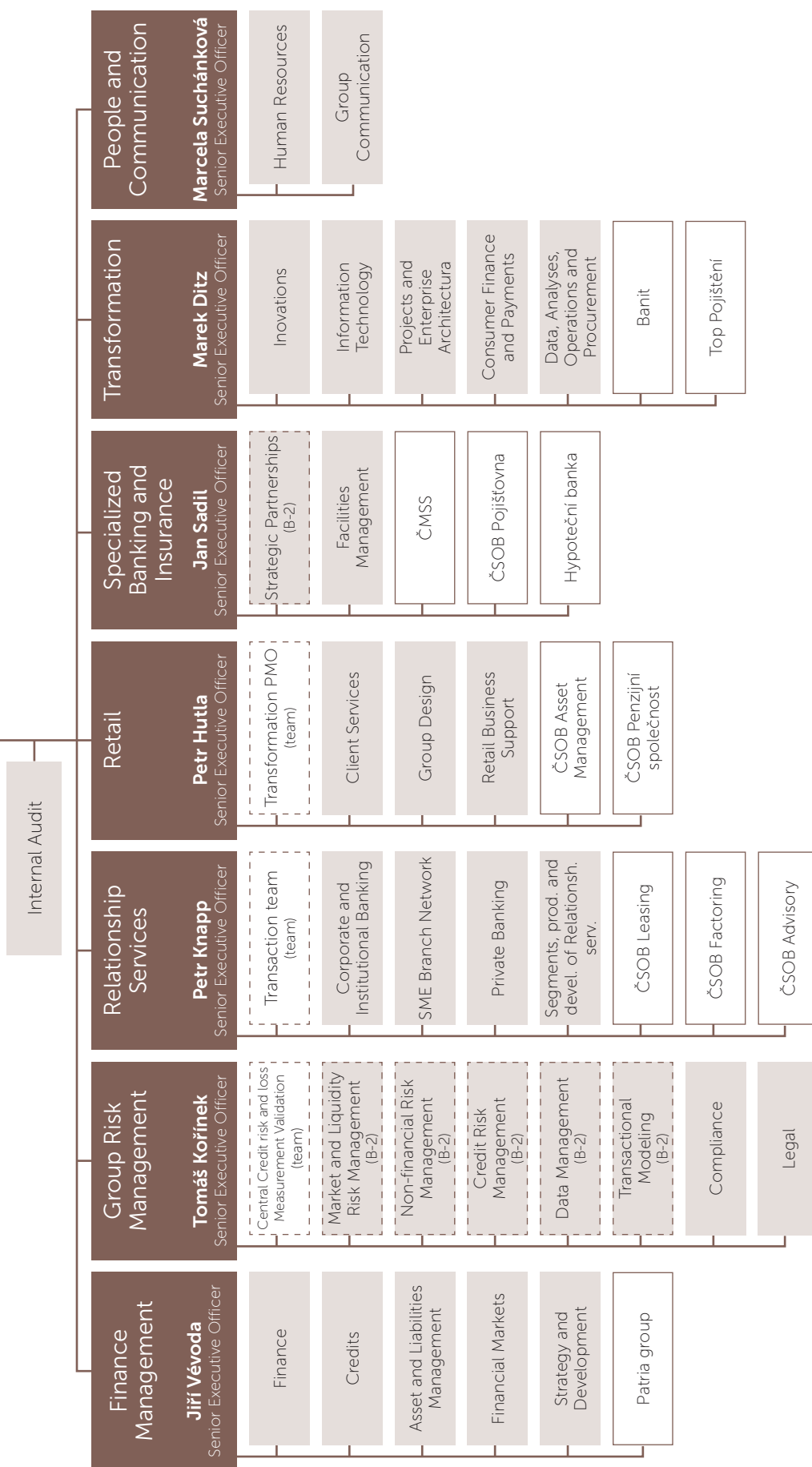
(as at 31 December 2016)



# ČSOB Organisation Chart

(from 1 March 2017)<sup>1)</sup>

Chief Executive Officer  
**John Arthur Hollows**



1) Decision of ČSOB's Board of Directors of 18 January 2017.

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## CONSOLIDATED FINANCIAL STATEMENTS

### CONSOLIDATED STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

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

(CZKm)	Note	2016	2015
Interest income	5	25,043	25,580
Interest expense	6	(2,808)	(3,277)
<b>Net interest income</b>		<b>22,235</b>	<b>22,303</b>
Fee and commission income		9,577	9,827
Fee and commission expense		(3,359)	(3,436)
<b>Net fee and commission income</b>	7	<b>6,218</b>	<b>6,391</b>
Dividend income		8	8
Net gains from financial instruments at fair value through profit or loss and foreign exchange	8	3,147	2,652
Net realised gains on available-for-sale financial assets		1,294	326
Other net income	9	1,141	862
<b>Operating income</b>		<b>34,043</b>	<b>32,542</b>
Staff expenses	10	(7,510)	(7,007)
General administrative expenses	11	(6,873)	(8,063)
Depreciation and amortisation	22, 23	(1,268)	(617)
<b>Operating expenses</b>		<b>(15,651)</b>	<b>(15,687)</b>
Impairment losses	12	(708)	(1,081)
Share of profit of associates and joint ventures	19	696	687
<b>Profit before tax</b>		<b>18,380</b>	<b>16,461</b>
Income tax expense	13	(3,232)	(2,472)
<b>Profit for the year</b>		<b>15,148</b>	<b>13,989</b>
<b>Attributable to:</b>			
Owners of the parent		15,141	14,010
Non-controlling interests		7	(21)

The accompanying notes are an integral part of these consolidated financial statements.

## **CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016**

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

(CZKm)	Note	2016	2015
<b>Profit for the year</b>		<b>15,148</b>	<b>13,989</b>
Net loss on cash flow hedges		(784)	(729)
Net (loss) / gain on available-for-sale financial assets		(2,080)	283
Share of other comprehensive income of associates and joint ventures		(32)	(17)
Income tax benefit relating to components of other comprehensive income		545	83
<b>Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods</b>	31	<b>(2,351)</b>	<b>(380)</b>
<b>Total comprehensive income for the year, net of tax</b>		<b>12,797</b>	<b>13,609</b>
<b>Attributable to:</b>			
Owners of the parent		12,789	13,639
Non-controlling interests		8	(30)

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

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

(CZKm)	Note	2016	2015
<b>ASSETS</b>			
Cash and balances with central banks	15	57,074	117,287
Financial assets held for trading	16	20,008	29,494
Financial assets designated at fair value through profit or loss	16	-	15
Available-for-sale financial assets	17	56,938	59,961
Held-to-maturity investments	17	132,679	136,433
Loans and receivables	18	783,223	579,448
Fair value adjustments of the hedged items in portfolio hedge		852	957
Derivatives used for hedging	20	11,656	11,900
Current tax assets		25	96
Deferred tax assets	13	179	152
Investment in associates and joint ventures	19	4,957	4,970
Investment property	21	-	-
Property and equipment	22	10,009	7,662
Goodwill and other intangible assets	23	5,634	5,323
Non-current assets held-for-sale	24	52	363
Other assets	25	2,241	2,264
<b>Total assets</b>		<b>1,085,527</b>	<b>956,325</b>
<b>LIABILITIES AND EQUITY</b>			
Financial liabilities held for trading	26	40,044	29,970
Financial liabilities designated at fair value through profit or loss	26	1,620	-
Financial liabilities at amortised cost	27	931,757	812,205
Fair value adjustments of the hedged items in portfolio hedge		4,796	4,062
Derivatives used for hedging	20	10,532	10,774
Current tax liabilities		849	170
Deferred tax liabilities	13	1,576	2,162
Other liabilities	28	4,945	5,727
Provisions	29	673	536
<b>Total liabilities</b>		<b>996,792</b>	<b>865,606</b>
Share capital	30	5,855	5,855
Share premium		20,929	20,929
Statutory reserve		18,687	18,687
Retained earnings		38,877	38,517
Available-for-sale reserve	30	2,228	3,944
Cash flow hedge reserve	30	1,973	2,609
Shareholders' equity		88,549	90,541
Non-controlling interests, presented within equity		186	178
<b>Total equity</b>		<b>88,735</b>	<b>90,719</b>
<b>Total liabilities and equity</b>		<b>1,085,527</b>	<b>956,325</b>

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

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

(CZKm)	Attributable to equity holders of the parent					Non- controlling interest	Total Equity
	Share capital (Note: 30)	Share premium	Statutory reserve <sup>1)</sup>	Retained earnings	Other reserves (Note: 30)		
<b>At 1 January 2015</b>	<b>5,855</b>	<b>15,509</b>	<b>18,687</b>	<b>38,397</b>	<b>6,924</b>	<b>208</b>	<b>85,580</b>
Profit for the year	-	-	-	14,010	-	(21)	13,989
Other comprehensive income for the year	-	-	-	-	(371)	(9)	(380)
Total comprehensive income for the year	-	-	-	14,010	(371)	(30)	13,609
Increase of Share capital and Share premium	-	5,420	-	-	-	-	5,420
Dividends paid (Note: 14)	-	-	-	(13,208)	-	-	(13,208)
Acquisition of business under common control (Note: 3)	-	-	-	(682)	-	-	(682)
<b>At 31 December 2015</b>	<b>5,855</b>	<b>20,929</b>	<b>18,687</b>	<b>38,517</b>	<b>6,553</b>	<b>178</b>	<b>90,719</b>
<b>At 1 January 2016</b>	<b>5,855</b>	<b>20,929</b>	<b>18,687</b>	<b>38,517</b>	<b>6,553</b>	<b>178</b>	<b>90,719</b>
Profit for the year	-	-	-	15,141	-	7	15,148
Other comprehensive income for the year	-	-	-	-	(2,352)	1	(2,351)
Total comprehensive income for the year	-	-	-	15,141	(2,352)	8	12,797
Dividends paid (Note: 14)	-	-	-	(14,781)	-	-	(14,781)
<b>At 31 December 2016</b>	<b>5,855</b>	<b>20,929</b>	<b>18,687</b>	<b>38,877</b>	<b>4,201</b>	<b>186</b>	<b>88,735</b>

<sup>(1)</sup> The statutory reserve represents accumulated transfers from retained earnings in compliance with the Statutes of the Bank. This reserve is distributable based on the decision of the Board of Directors.

The accompanying notes are an integral part of these consolidated financial statements.

These consolidated financial statements were approved for issue by the Board of Directors and signed on its behalf on 20 April 2017 by:



John Arthur Hollows  
Chairman of the Board of Directors



Jiří Vévoda  
Member of the Board of Directors

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

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

(CZKm)	Note	2016	2015
<b>OPERATING ACTIVITIES</b>			
Profit before tax		18,380	16,461
Adjustments for:			
Change in operating assets	33	(30,889)	(6,951)
Change in operating liabilities	33	73,087	(15,027)
Non-cash items included in profit before tax	33	3,503	2,130
Net gains from investing activities		(39)	(73)
Income tax paid		(2,409)	(2,467)
<b>Net cash flows from / (used in) operating activities</b>		<b>61,633</b>	<b>(5,927)</b>
<b>INVESTING ACTIVITIES</b>			
Purchase of held-to-maturity investments		(4,848)	(6,589)
Maturity / disposal of investment securities		7,901	12,763
Purchase of property, equipment and intangible assets		(6,065)	(2,167)
Proceeds from disposal of property, equipment, intangible assets and assets held-for-sale		2,044	1,260
Proceeds from disposal of investment property		-	2
Dividends from associates and joint ventures		677	692
Acquisition of subsidiary, net of cash acquired (Note: 3)		-	(283)
Reintegration of information and communication services (Note: 3)		(955)	(1,136)
<b>Net cash flows (used in) / from investing activities</b>		<b>(1,246)</b>	<b>4,542</b>
<b>FINANCING ACTIVITIES</b>			
Repayment of bonds		(2,700)	(4,918)
Issue of bonds		3,037	2,541
Increase of share capital and share premium		-	5,420
Dividends paid	14	(14,781)	(13,208)
<b>Net cash flows used in financing activities</b>		<b>(14,444)</b>	<b>(10,165)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>		<b>45,943</b>	<b>(11,550)</b>
Cash and cash equivalents at the beginning of the year	33	44,370	55,920
Net increase / (decrease) in cash and cash equivalents		45,943	(11,550)
<b>Cash and cash equivalents at the end of the year</b>	33	<b>90,313</b>	<b>44,370</b>
<b>Operational cash flows from interest and dividends</b>			
Interest paid		(3,366)	(3,732)
Interest received		26,669	26,584
Dividends received (other than from associates and joint ventures)		8	8

The accompanying notes are an integral part of these consolidated financial statements.



## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

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

### **1. CORPORATE INFORMATION**

Československá obchodní banka, a. s. (the Bank or ČSOB) is a Czech joint-stock company with its registered office at Radlická 333/150, Prague 5, Czech Republic; the corporate ID is 00001350. ČSOB is a universal bank having its operations in the Czech Republic and offering its domestic and foreign customers a wide range of financial services and products in Czech Crowns and foreign currencies. The parent company of the Bank is KBC Bank NV (KBC Bank), which is controlled by the KBC Group NV (KBC Group).

The main activities of the Bank include: accepting deposits from the public, providing loans, investing in securities on the Bank's own account, financial leasing, payments and clearance, the issuance and administration of payment instruments, the provision of guarantees, the issuance of letters of credit, the provision of collection services, the provision of all investment service according to a special law, the issuance of mortgage bonds, financial brokerage, the provision of depository services, exchange office services (purchase of foreign exchange), the provision of banking information, trading in foreign exchange values and gold on the Bank's own account or on a client's account, the rental of safe-deposit boxes. In addition, the Bank performs activities directly related to the activities described above and activities carried out for other parties if they relate to the running of the Bank and operation of other banks, financial institutions and enterprises providing ancillary banking services, controlled by the Bank.

Furthermore, the ČSOB group (Group) (Note: 3) provides its clients with financial services in the following areas: building savings and mortgages, asset management, collective investments, pension insurance, leasing, factoring and the distribution of life and non-life insurance products.

### **2. ACCOUNTING POLICIES**

#### **2.1 Basis of preparation**

The financial statements have been prepared and approved by the Board of Directors of the Bank. In addition, the financial statements are subject to approval at the General Meeting of shareholders.

The consolidated financial statements have been prepared under the historical cost convention, except for available-for-sale investments, financial assets and financial liabilities at fair value through profit or loss and all derivative contracts that have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortised cost, are adjusted to record changes in fair value attributable to the risks that are being hedged. Assets held for sale are measured at fair value less cost to sell if this value is lower than their carrying amount (i.e. cost less accumulated depreciation and impairment losses).

The consolidated financial statements are presented in millions of Czech Crowns (CZK<sup>m</sup>), which is the presentation currency of the Group.

#### **Statement of compliance**

The Group consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU IFRS).

#### **Basis of consolidation**

The consolidated financial statements include the Bank, all subsidiary companies that are controlled by the Bank (subsidiaries), all companies jointly controlled by the Bank (joint ventures) and all companies over which the Bank has significant influence (associates). The accounting policies of subsidiaries and joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

All intra-group balances, transactions, income and expenses, and gains and losses resulting from intra-group transactions are eliminated.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group controls an investee if, and only if, the Group has:

- power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee;
- the ability to use its power over the investee to affect its returns.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

Non-controlling interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the consolidated statement of income, consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from the parent shareholder's equity.

Joint ventures and associates included in the Group consolidation are accounted for using the equity method.

## **2.2 Significant accounting judgements and estimates**

While applying the Group accounting policies, the management has used its judgement and made estimates in determining the amounts recognised in the financial statements. The most significant judgements and estimates are as follows:

### **Fair value of financial instruments (Note: 32)**

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques which include the application of mathematical models. If possible, the input to these models is taken from observable markets; if not, a degree of judgement is required to establish fair values. The judgements include considerations of credit, liquidity and model inputs such as correlation and volatility for longer-dated financial instruments.

### **Impairment losses on financial instruments (Note: 40.2)**

The Group reviews its financial instruments at each reporting date to assess whether an allowance for impairment should be recorded in the statement of income. In particular, management judgement is required to estimate the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions regarding a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowances, the Group also makes a collective impairment allowance against exposures which, although not individually identified as requiring a specific allowance, have a greater risk of default than when originally granted.

Management judgement is required to assess the fair value of collateral, which has a significant effect on the impairment allowance.

### **Goodwill impairment (Note: 23)**

Goodwill is tested annually for impairment. For this purpose, goodwill acquired in a business combination is allocated to the cash-generating unit which is expected to benefit from the synergies of the combination. A cash-generating unit represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Identifying a cash-generating unit as well as determining its recoverable amount requires judgement.

### **Assessment of the nature of interest in Group entities**

The Group considers all relevant facts and circumstances in assessing whether it has a control, joint control (and its type) or significant influence over an investee. The assessment is based on the conclusions made by taking into account the contractual arrangements with the other vote holders of the investee, rights arising from other contractual arrangements and the Group's voting rights and potential voting rights.

## 2.3 Changes in accounting policies

### Effective from 1 January 2016

The accounting policies adopted are consistent with those used in the previous financial year except for the adoption of the following standards, amendments and interpretations. The adoption of them did not have any effect on the financial performance or position of the Group, unless otherwise described below.

**Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)** is effective for periods beginning on or after 1 January 2016. The amendment requires an acquirer of an interest in a joint operation to apply all of the principles on business combinations (IFRS 3) except for those that conflict with the guidance in this amendment.

**Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, 12 and IAS 28)** is effective for periods beginning on or after 1 January 2016. The amendments further clarify the exception in consolidating investment entities.

**Disclosure Initiative (Amendments to IAS 1)** is effective for periods beginning on or after 1 January 2016. The amendments clarify that companies should use professional judgment in determining where and in what order information is presented in the financial disclosures. The amendments state that materiality applies to the whole of financial statements and that the inclusion of immaterial information can inhibit the usefulness of financial disclosures.

**Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)** is effective for periods beginning on or after 1 January 2016. The amendment clarifies the use of a revenue-based method for depreciating an asset.

**Annual Improvements to IFRSs (2012 - 2014 Cycle)**, issued in September 2014 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard, all of which are applicable on or after 1 January 2016.

### Effective after 1 January 2016

The following standards, amendments and interpretations have been issued and are effective after 1 January 2016. The Group has decided not to early adopt them. Unless otherwise described below, the new standards, amendments and interpretations are not expected to significantly affect the Group financial statements.

**IFRS 9 Financial Instruments (2014)** is effective for periods beginning on or after 1 January 2018. A project relating to IFRS 9 has been running for some time at a group and local level. In 2016, it moved from the design phase to the implementation phase, which will continue in 2017. The project is structured along two pillars: namely classification & measurement and impairment, as well as a common work stream relating to the impact on reporting and disclosures.

#### Classification and measurement of financial instruments

Financial assets are measured at amortised cost if both conditions are fulfilled:

- The financial asset is held within the business model whose objective is to hold the assets to collect the contractual cash flows; and
- The contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal outstanding.

Financial assets are measured at fair value through other comprehensive income if both conditions are fulfilled:

- The financial asset is held within the business model whose objective is to hold the assets to collect the contractual cash flows and to sell; and
- The contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal outstanding.

Other financial assets are measured at fair value through profit or loss. IFRS 9 retains a fair value option. Reclassifications between the three asset categories are required when the entity changes its business model.

All equity instruments are measured at fair value either through other comprehensive income or profit or loss.

IFRS 9 removes the separation of embedded derivatives requirements for financial assets and the instrument is assessed in its entirety as to whether it fulfils the above two conditions.

Classification and measurement of financial assets under IFRS 9 will depend on the specific business model in place and the assets' contractual cash flow characteristics. The project is in a stage where all business models have been identified, analysed and documented, as to a large extent have the characteristics of cash flows. Based on current market conditions, regulation, interpretation, assumptions and policies, the impact of first time application is currently expected to be limited and would be reflected primarily in a potential rebalancing of the treasury portfolio (reclassification from available-for-sale to amortized cost) and the reversal of frozen available-for-sale reserves. These frozen reserves exist under IAS 39 due to historical reclassifications out of the Available-for-sale category to the held-to-maturity or loans-and-receivables categories, but need to be reversed on transition to IFRS 9.

Financial liabilities are classified and measured either at amortised cost or at fair value through profit or loss. A financial liability can be designated as measured at fair value through profit or loss if doing so results in more relevant information, because either:

- It eliminates or reduces a measurement or recognition inconsistency;
- A group of financial liabilities is managed and its performance is evaluated on a fair value basis.

IFRS 9 requires that changes in the fair value of an entity's own debt, which is designated at fair value through profit or loss, caused by changes in its own credit quality are recognised in other comprehensive income, unless the treatment of the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss.

For financial liabilities, IFRS 9 changes the presentation of gains and losses on own credit risk for financial instruments designated at fair value through profit or loss. The Group will early adopt this aspect of IFRS 9 with effect from 1 January 2017 and the gains and losses on own credit risk will be recognized as part of other comprehensive income. The Group is analysing the impact of early adoption of own credit risk.

The original requirements related to the derecognition of financial assets and financial liabilities are carried forward unchanged from IAS 39 to IFRS 9.

### **Impairment of financial assets**

IFRS 9 introduces a three-stage model based on changes in credit quality since initial recognition.

Stage 1 includes financial instruments that have not had a significant increase in credit risk since initial recognition, or have low credit risk at the reporting date. 12-month expected credit losses are recognised for these assets. Interest income is based on the gross carrying amount of the assets.

Stage 2 includes financial instruments that have had a significant increase in credit risk since initial recognition, but that do not have objective evidence of impairment. Lifetime expected credit losses are recognised for these assets. Interest income is still calculated on the gross carrying amount of the assets.

Stage 3 includes financial instruments that have objective evidence of impairment at the reporting date. Lifetime expected credit losses are recognised for these assets. Interest income is calculated on the net carrying amount of the assets.

The new model is applied to debt instruments measured at amortised cost or fair value through other comprehensive income, loan commitments and financial guarantee contracts not measured at fair value through profit or loss and lease/trade receivables. There are simplifications available for trade receivables, lease receivables and contract assets that do not contain a significant financing component. The 12-month expected credit losses do not have to be calculated and lifetime expected credit losses are used instead. For the trade and lease receivables and contract assets with a significant financing component there is a policy choice to apply either the simplified or general model.

The accounting for impairment of financial assets will have a significant impact on the Group. The assessment is in progress.

The Group has established policies and processes to assess whether credit risk has increased significantly at the end of each reporting period and, therefore, “staging” is required (i.e. moving from one stage to another). For the loan portfolio, a multi-tier approach has been adopted to staging, based on internal credit ratings, forbearance measures, collective assessment and days past due as a backstop. A similar multi-tier approach will be used for the investment portfolio except that the Group intends to use the low-credit-risk exemption, meaning that all bonds in scope with a probability of default grade (PD) of 1 to 3 are considered to be in Stage 1, unless any of the other triggers indicate otherwise. For Stage 1 and Stage 2 - under IAS 39 - the Group records incurred-but-not-reported (IBNR) impairment losses, which are influenced by emergence periods. Under IFRS 9, impairment of financial assets is calculated on a 12-month expected credit loss (ECL) basis for Stage 1 and on a lifetime ECL basis for Stage 2. As a consequence, impairment levels are generally expected to increase. The Group does not expect major impact on Stage 3.

### Hedge accounting

The Group intends to use the option to continue with hedge accounting under IAS 39 and to await further developments at the IASB regarding macro hedging.

**Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)** does not yet have a set effective date. The amendments clarify the accounting for transactions where a parent loses control of a subsidiary that does not constitute a business as defined in IFRS 3. The gain or loss resulting from the sale or contribution to an associate or a joint venture of assets is recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in the associate or joint venture.

**IFRS 15 Revenue from Contracts with Customers** is effective for periods beginning on or after 1 January 2018. The key concept of the new standard is identifying separate Performance Obligations. Entities will follow a five-step model for revenue recognition:

1. Identify the contract with the customer (a contract exists only when it is 'probable' that the entity will collect the consideration);
2. Identify separate Performance Obligations in the contract (a promise to transfer good or service);
3. Determine the transaction price (only an amount not subject to subsequent future reversals);
4. Allocate the transaction price to each Performance Obligation;
5. Recognise revenue when or as each Performance Obligation is satisfied.

As the standard is not applicable to insurance contracts, financial instruments or lease contracts, the impact on the Group will be limited. The assessment of the impact is in progress.

**IFRS 16 Leases** is effective for annual periods beginning on or after 1 January 2019 and has not yet been endorsed by the EU. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognize most leases in their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The Group is currently assessing the impact that IFRS 16 will have on the financial statements.

**Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)** is effective for annual periods beginning on or after 1 January 2018 and has not yet been endorsed by the EU. The amendment permits insurers that meet specified criteria to apply a temporary exemption from IFRS 9. Further it permits insurers to apply the overlay approach to designated financial assets and to reclassify in specified circumstances some or all of their financial assets so that the assets are measured at fair value through profit or loss.

**Clarifications to IFRS 15 (Amendment to IFRS 15)** is effective for periods on or after 1 January 2018. The amendment clarifies three separate topics within the IFRS 15: how to assess control in principal versus agent considerations; when an entity's activities significantly affect intellectual property in licensing agreements and expands a definition of what “distinct goods and services” mean.



**Disclosure Initiative (Amendment to IAS 7)** is effective for periods on or after 1 January 2017.

The amendment requires that the following changes in liabilities arising from financing activities are disclosed: (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

**Recognition of Deferred Tax Assets for Unrealised Losses (Amendment to IAS 12)** is effective for periods on or after 1 January 2017. The amendment addresses the question of whether an unrealised loss on a debt instrument measured at fair value gives rise to a deductible temporary difference.

**Transfers of Investment Property (Amendment to IAS 40)** is effective for periods on or after 1 January 2018. The amendment clarifies the guidance on transfers to or from investment properties, in terms of the definition of "changes in use".

**IFRIC 22 Foreign Currency Transactions and Advance Consideration** is effective for periods on or after 1 January 2018. The interpretation gives a guidance on determining a date of transaction for the purpose of determining the exchange rate in transactions involving advance consideration in foreign currency.

**Annual Improvements to IFRS Standards (2014 - 2016 Cycle)**, issued in December 2016 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard, two of which are applicable on or after 1 January 2018 and one on or after 1 January 2017.

## 2.4 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below.

### (1) Foreign currency translation

Items included in the financial statements of each of the Group's entities are initially measured using the currency of the primary economic environment in which the entity operates ("the functional currency").

Transactions in foreign currencies are initially recorded at the functional currency rate of exchange prevailing at the date of transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange prevailing at the end of the reporting period. All differences are taken to Net gains/losses from financial instruments at fair value through profit or loss and foreign exchange (Net gains/losses from financial instruments at fair value through profit or loss onwards) in the statement of income with the exception of differences in foreign currency borrowing or derivatives that provide an effective hedge in the cash flow hedge of currency risk which are taken through OCI directly to equity until the hedged cash flow influences the statement of income, at which time they are recognised in the statement of income as well.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates prevailing at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates prevailing at the end of the reporting period. Exchange differences from non-monetary available-for-sale financial assets are included in the fair value revaluation recognised in equity until the assets are derecognised or impaired.

The results and financial position of all the Group entities, which have a functional currency different from the presentation currency, are translated into the presentation currency as follows:

- assets and liabilities at the year-end exchange rates;
- income and expenses at the average exchange rates for the year (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions);
- all resulting exchange differences are recognised through OCI as a separate component of equity in the Foreign currency translation reserve.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken through OCI to the Foreign currency translation reserve. When a foreign entity is sold, such exchange differences are recognised in the statement of income as part of the gain or loss on sale.

## **(2) Financial instruments - recognition and derecognition**

Financial assets and liabilities are recognised in the statement of financial position when the Group becomes a party to the contractual provisions of the financial instrument, except for "regular way" purchases and sales of financial assets (see below). A financial asset is derecognised from the statement of financial position when the contractual rights to the cash flows from the financial asset expire or are transferred and the transfer qualifies for derecognition. A transfer requires that the Group either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognised. Where the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement. A financial liability is derecognised from the statement of financial position when the obligation specified in the contract is discharged, cancelled or expires.

A "regular way" purchase or sale of a financial asset is one in which the delivery of the asset is made within the time frame generally established by regulation or convention of the particular market concerned. For all categories of financial assets the Group recognises "regular way" purchases and sales using settlement date accounting. Under settlement date accounting, a financial asset is recognised or derecognised in the statement of financial position on the day it is physically transferred to or from the Group ("settlement date"). The date on which the Group becomes a party to the contractual provisions of a financial asset purchase or the Group loses control of the contractual rights from a financial asset sale is commonly referred to as the "trade date". For financial assets at fair value through profit or loss and available-for-sale financial assets, fair value movements between the "trade date" and "settlement date" in connection with purchases and sales are recognised in Net gains/losses from financial instruments at fair value through profit or loss and in the Available-for-sale reserve, respectively. On the settlement date, a respective financial asset or liability is recognised in or derecognised from the statement of financial position.

## **(3) Financial instruments - initial recognition and subsequent measurement**

The classification of financial instruments depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

### *(i) Financial assets or financial liabilities at fair value through profit or loss*

This category has two sub-categories: financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss at inception.

Financial assets or financial liabilities held for trading consist of derivatives held for trading and financial instruments other than derivatives held for trading.

- *Derivatives held for trading*

Derivatives include foreign exchange contracts, interest rate futures, forward rate agreements, currency and interest rate swaps, and currency, interest rate and commodity options. Derivatives are recorded at fair value and carried as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of derivatives held for trading are included in Net gains/losses from financial instruments at fair value through profit or loss.

Changes in the clean fair value (fair value less any net interest accrual) of derivatives used as economic hedges are recognised in Net gains/losses from financial instruments at fair value through profit or loss. Net interest income/expense from these derivatives is recorded in Net interest income on a deal by deal basis.

The derivatives used as economic hedges are derivatives, which do not meet the IFRS requirements for applying hedge accounting but which the Group Asset Liability Management department uses for decreasing the interest rate risk of the Group, and thus lowering net interest income volatility, i.e. for hedging purposes from an economic point of view.

The Group occasionally purchases or issues financial instruments containing embedded derivatives. An embedded derivative is separated from the host contract and carried at fair value if the economic characteristics of the derivative are not closely related to the economic characteristics of the host contract and the hybrid instrument is not classified as at fair value through profit or loss. If a separated derivative does not qualify as a hedging derivative, it is designated as a trading derivative. To the extent that the Group cannot reliably identify and measure the embedded derivative, the entire contract is carried at fair value in the statement of financial position with changes in fair value reflected in the statement of income.

- *Financial instruments held for trading other than derivatives*

Financial assets or financial liabilities held for trading other than derivatives are recorded in the statement of financial position at fair value. Changes in clean fair value are recognised in Net gains/losses from financial instruments at fair value through profit or loss. Interest income or expense is recorded in Net interest income using the effective interest rate method. Dividends received are recorded in Dividend income. A financial asset or financial liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the near term.

- *Financial instruments designated at fair value through profit or loss*

Financial assets and financial liabilities designated at fair value through profit or loss on initial recognition are classified in this category when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- the assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in clean fair value are recorded in Net gains/losses from financial instruments at fair value through profit or loss. Interest income or expense is recorded in Net interest income using the effective interest rate method.

(ii) *Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. Were the Group to sell or reclassify other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale.

After initial measurement, held-to-maturity investments are measured at amortised cost using the effective interest rate method, less any allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in Interest income. The losses arising from the impairment of such investments are recognised in the statement of income in Impairment losses.



*(iii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Group has no intention of trading the financial asset.

After initial measurement, loans and receivables are measured at amortised cost using the effective interest rate method, less any allowance for impairment, except in the case of a fair value hedge of items in this category, which have to be fair valued to the extent of the hedged risk. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in Interest income. The losses arising from the impairment of such investments are recognised in the statement of income in Impairment losses.

*(iv) Available-for-sale financial assets*

Available-for-sale financial assets are those which are designated as such or do not qualify to be classified as designated at fair value through profit or loss, held-to-maturity or loans and receivables.

After initial measurement, available-for-sale financial assets are measured at fair value. Unrealised gains and losses are recognised directly in equity in the Available-for-sale reserve on an after-tax basis, until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the statement of income. When an available-for-sale asset is disposed of, the unrealised gain or loss recorded in the Available-for-sale reserve is reclassified to Net realised gains/losses on available-for-sale financial assets. Interest income arising from available-for-sale assets, calculated using the effective interest rate method, is recorded separately in Net interest income. Dividends received from available-for-sale equity shares are recorded in Dividend income.

*(v) Financial liabilities at amortised cost*

Financial liabilities at amortised cost are non-derivative financial liabilities where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder.

After initial measurement, those financial liabilities are measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

*(vi) 'Day 1' profit or loss*

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument, or the fair value based on a valuation technique whose variables include only data from observable markets, the Group immediately recognises the difference between the transaction price and the fair value (a Day 1 profit or loss) in the statement of income in Net gains/losses from financial instruments at fair value through profit or loss. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the statement of income when the inputs become observable, or when the instrument is derecognised.

#### **(4) Repurchase and reverse repurchase agreements**

Securities sold under agreements to repurchase at a specified future date (repos) remain in the statement of financial position. The corresponding cash received is recognised in the statement of financial position in Financial liabilities held for trading or Financial liabilities at amortised cost, reflecting its economic substance as a loan to the Group. The difference between the sale and repurchase price is recorded as Interest expense and is accrued over the life of the agreement.

Conversely, securities purchased under agreements to resell at a specified future date (reverse repos) are not recognised in the statement of financial position. The corresponding cash paid is recognised in the statement of financial position in Financial assets held for trading or Loans and receivables or Cash and balances with central banks. The difference between the purchase and resale price is recorded as Interest income and is accrued over the life of the agreement.

## (5) Determination of fair value

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (ie an exit price). Financial instruments classified as financial assets and financial liabilities at fair value through profit or loss or available-for-sale are fair valued using quoted market prices if there is a published price quotation in an active market. For financial instruments that are not traded on an active market their fair values are estimated using pricing models utilising quoted prices of instruments with similar characteristics, discounted cash flows methods or other models. Those fair value estimation techniques are significantly affected by assumptions used by the Group including the discount rate, liquidity and credit spreads and estimates of future cash flows.

## (6) Impairment of financial assets

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of assets that can be reliably estimated. Objective evidence that a financial asset or a group of assets is impaired includes observable data that comes to the attention of the Group about the following loss events:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the Group would not otherwise consider;
- it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - adverse changes in the payment status of borrowers in the group; or
  - national or local economic conditions that correlate with defaults on the assets in the group.

### (i) Assets carried at amortised cost

The Group assesses objective evidence of impairment individually or collectively for financial assets at amortised cost. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period. The assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recorded in the statement of income.

When a loan is uncollectible, it is written off against the related allowance for impairment. Such loans are written off after all the necessary procedures for collecting the loan have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the statement of income in Impairment losses.

As part of its treatment of defaulted loans, the Group can take over assets that were granted as collaterals. Upon repossession, the assets are valued at their presumed realisable value and booked in inventory.

#### *(ii) Renegotiated loans*

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due, however, the rating of the client cannot be improved only based on the restructuring. The management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject of an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

#### *(iii) Financial assets carried at fair value*

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of a debt instrument classified as available-for-sale, the assessment of impairment is based on the same criteria as financial assets carried at amortised cost. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. A significant decline is considered to be a 30% decline in the fair value. A prolonged decline is considered to be a decline of one year or longer. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the statement of income - is removed from equity and recognised in the statement of income. Impairment losses recognised in the statement of income on equity instruments are not reversed through the statement of income. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of income, the impairment loss is reversed through the statement of income.

### **(7) Impairment of non-financial assets**

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. The recoverable amount is determined for an individual asset.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Group makes an estimate of the recoverable amount. A previous impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of income.

## **(8) Hedge accounting**

The Group uses instruments, designated as hedging instruments as cash flow hedges or fair value hedges to manage the Group's interest rate risk or foreign currency risk. Cash flow hedges and fair value hedges are used to minimise the variability in cash flows of interest-earning assets or interest-bearing liabilities or anticipated transactions caused by interest rate fluctuations or to minimise the variability in the fair value of asset or liability, which could affect the statement of income. Hedge accounting is used for derivatives and other financial instruments designated in this way provided certain criteria are met. The Group's criteria for the application of hedge accounting include:

- formal documentation of the hedging instrument, hedged item, hedging objective, strategy and relationship is prepared before hedge accounting is applied;
- the hedge is documented at inception showing that it is expected to be highly effective in offsetting the risk in the hedged item throughout the reporting period;
- the hedge is highly effective on an ongoing basis. The hedge is considered to be highly effective if the Group achieves offsetting changes in cash flows between 80% and 125% for the risk being hedged.

The Group has complied with the amended standard, taking into account the 'carved out' parts as approved by the European Commission.

### *(i) Cash flow hedges*

The effective portion of the change in fair value of a cash flow hedging derivative is recorded in the Cash flow hedge reserve. The ineffective portion is recorded directly in Net gains/losses from financial instruments at fair value through profit or loss. Amounts in the Cash flow hedge reserve are reclassified into the statement of income in a manner consistent with the earnings recognition pattern of the underlying hedged item. If a cash flow hedge is terminated or the hedge designation removed the related remaining amounts in the Cash flow hedge reserve are reclassified into the statement of income in the same period during which the hedged item affects income. If the hedged anticipated transaction is no longer expected to occur the related remaining amounts in the Cash flow hedge reserve are recognised immediately in the statement of income.

### *(ii) Fair value hedges*

For designated and qualifying fair value hedges, the change in the fair value of a hedging instrument is recognised in the statement of income. Related interest income/expense from the hedging instrument is recorded in Net interest income, revaluation of the hedging instrument is recognised in Net gains/losses from financial instruments at fair value through profit or loss. Meanwhile, the change in fair value of the hedged item attributable to the risk hedged is recorded as part of the carrying value of the hedged available-for-sale financial asset or on a separate line Fair value adjustments of the hedged items in portfolio hedge if the hedged item is financial asset or liability measured at amortised cost. The change in fair value of the hedged item and is also recognised in the statement of income in Net gains/losses from financial instruments at fair value through profit or loss. If the hedging instrument expires, is sold, terminated or exercised or if the hedge is not assessed as effective any more, then the hedge accounting is discontinued.

For fair value hedges relating to items carried at amortised cost, any adjustment to the carrying value is amortised through the statement of income over the remaining term of the hedge using the effective interest rate method. Amortisation begins as soon as an adjustment exists but no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. If the hedged item is derecognised, the unamortised fair value is recognised immediately in the statement of income.

## (9) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

## (10) Reclassification of financial assets

The Group does not reclassify any financial assets into or out of the Financial assets designated at fair value through profit or loss after initial recognition.

If a non-derivative financial asset at fair value through profit or loss is no longer held for selling or repurchasing it can only be reclassified in rare circumstances.

The Group can also reclassify, under certain circumstances, financial assets out of Available-for-sale. A financial asset classified as Available-for-sale that would have met the definition of loans and receivables may be reclassified out of the Available-for-sale category to the loans and receivables category if the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. A financial asset classified as Available-for-sale that would have met the definition of held-to-maturity investment may be reclassified out of the Available-for-sale category to the held-to-maturity investment category if the Group has the intention and ability to hold the financial asset until maturity.

Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

For a financial asset reclassified out of the Available-for-sale category, any previous gain or loss on that asset that has been recognised in equity is amortised in the statement of income over the remaining life of the investment using the effective interest rate. Any difference between the new amortised cost and the expected cash flow is also amortised over the remaining life of the asset using the effective interest rate.

Sales and reclassifications from the Held-to-maturity portfolio without the risk of triggering tainting rules are possible only in limited circumstances, such as when it concerns an insignificant amount of instruments or instruments that are so close to maturity that the changes in the market interest rates would not significantly change their fair value. Further, no tainting rules are applied if the sales or reclassifications are attributable to an isolated event that is beyond the Group's control (i.e. significant deterioration in the issuer's creditworthiness or changes in tax, statutory or regulatory requirements) or if the sales occur after collecting a substantial amount of the instrument's principal.

However, if sales or reclassifications from the Held-to-maturity portfolio do not fulfil the above limits, any remaining investments have to be reclassified as available-for-sale. Furthermore, no financial assets can be classified as Held-to-maturity for the following two years.

## (11) Leasing

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

### (i) Group company as a lessee

The leases entered into by the Group are primarily operating leases. The total payments made under operating leases are charged to the statement of income on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

### (ii) Group company as a lessor

Finance leases, where the Group transfers substantially all the risk and benefits incidental to ownership of the leased item to the lessee, are reflected as finance lease receivables in the statement of financial position in Loans and receivables. A receivable is recognised over the leasing period at an amount equaling the present value of the lease payments using the implicit rate of interest and including any guaranteed residual value. All income resulting from the receivable is included in Interest income in the statement of income.



Leases, in which the Group does not transfer substantially, all the risks and benefits of ownership of the asset, are classified as operating leases. The Group leases out certain of its properties under operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned. Rental income and depreciation relating to operating lease assets is included as a net amount in Other net income.

## **(12) Recognition of income and expenses**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

### *(i) Interest income and expense*

For all financial instruments measured at amortised cost and interest bearing financial instruments classified as available-for-sale financial investments, interest income or expense is recorded using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest income and expense of interest-bearing non-derivative financial instruments in the held-for-trading portfolio designated at fair value through profit or loss portfolio, derivatives used as economic hedges and hedging derivatives are also recognised in the caption using the effective interest rate method.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

### *(ii) Fee and commission income*

Fees and commissions that are not an integral part of the effective interest rate are generally recognised on an accrual basis when the service has been provided. Origination fees for loans that are probable of being drawn down, are deferred and recognised as an integral part of the effective interest on the loan. Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, are recognised on the completion of the underlying transaction. Recognition of portfolio and other management advisory and service fees is based on the applicable service contracts. Asset management fees relating to investment funds are accrued over the period for which the service is provided. Commissions from sales of insurance products are based on the applicable contract and accrued over the contractual period.

### *(iii) Dividend income*

Revenue is recognised when the Group's right to receive a payment is established.

### *(iv) Net gains / losses from financial instruments at fair value through profit or loss*

Net gains / losses from financial instruments at fair value through profit or loss include all gains and losses from changes in the clean fair value of financial assets and financial liabilities held for trading and those designated at fair value through profit or loss except for trading derivatives that are not used as economic hedges, where the interest income/expense is also included. This caption also includes net gains from fair value hedging constructions (revaluation of hedging and hedged items) and any ineffectiveness recorded in cash flow hedging transactions.

### (13) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 3 months maturity from the date of acquisition including: cash and balances with central banks, loans and advances (measured at amortised cost) to credit institutions and central banks and financial liabilities at amortised cost to credit institutions and central banks. Only highly liquid transactions contracted with general government bodies (reverse repo / repo operations) are assessed by the Group as cash equivalents.

### (14) Investment property

The Group holds certain properties as investments to earn rental income, for capital appreciation or both. Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are carried at cost less any accumulated depreciation and any accumulated impairment losses. Depreciation is calculated using the straight-line method to write off the cost of each asset to its residual value over its estimated useful life. The accounting policy outlined for property and equipment also applies to investment property.

### (15) Investments in associates and joint ventures

Associates are all entities over which the Group has significant influence but not control or joint control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Investments in associates are accounted for using the equity method. Under the equity method, the investment in an associate or a joint venture is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture is included in the carrying amount of the investment and is not tested for impairment individually.

The statement of income reflects the Group's share of the results of operations of the associate or joint venture. Any change in OCI of those investees is presented as part of the Group's OCI. In addition, when there has been a change recognised directly in the equity of the associate or joint venture, the Group recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

The aggregate of the Group's share of profit or loss of an associate and a joint venture is shown on the face of the statement of income outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate or joint venture.

The financial statements of the associate or joint venture are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment in its associate or joint venture. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate or joint venture is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate or joint venture and its carrying value, and then recognises the loss as 'Share of profit of associates and joint ventures' in the statement of income.

Upon loss of significant influence over the associate or joint control over the joint venture, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate or joint venture upon loss of significant influence or joint control and the fair value of the retained investment and proceeds from disposal is recognised in profit or loss.

## (16) Property and equipment

Property and equipment includes Group occupied properties, IT and communication and other machines and equipment.

Land is carried at cost. Buildings and equipment are carried at cost less accumulated depreciation and impairment if any. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Depreciation is calculated using the straight-line method to write off the cost of each asset to its residual value over its estimated useful life, as follows:

Buildings	30 years
IT equipment	4 years
Office equipment	10 years
Other	4-30 years

Gains and losses on disposals are determined by comparing the proceeds received in the transaction with the carrying amount of the asset. The resulting gains and losses are included as a net amount in Other net income.

Property and equipment is reviewed for impairment at the end of each reporting period or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

When it is highly probable that an asset will be sold, the asset is classified in Non-current assets held-for-sale at the lower of its carrying amount and fair value less costs to sell.

## (17) Business combinations and goodwill

The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the total of the fair values of assets transferred, equity instruments issued and liabilities incurred or assumed at the date of exchange. Non-controlling interests in the acquirees are measured at the proportionate share of the acquiree's recognised net identifiable assets. Any acquisition-related costs are recognised in the statement of income when they are incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

Goodwill as of the acquisition date is measured as the excess of the aggregate of the consideration transferred and the amount of non-controlling interest over the net of the identifiable assets acquired and the liabilities assumed at the date of acquisition.

If a bargain purchase is made, in which the net of the acquisition-date amounts of identifiable assets acquired and liabilities assumed is larger than the aggregate of the consideration transferred and the amount of non-controlling interest in the acquiree, the resulting gain is recognised in the statement of income at the date of acquisition.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to the cash-generating unit which is expected to benefit from the synergies of the combination. A cash-generating unit represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

Impairment losses relating to goodwill cannot be reversed in future periods.

The pooling of interest method of accounting is used to account for the business combination of entities or businesses under common control. It means a business combination in which all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination.

The assets and liabilities of the combining entities are reflected at their carrying amounts and no new assets and liabilities are recognised at the date of combination. No new goodwill is recognised as a result of the combination.



Any difference between the consideration paid and the carrying amounts of assets and liabilities acquired is reflected through equity.

The income statement reflects the results of the combining entities only since the date, when the control was obtained by the Group.

### (18) Intangible assets

Intangible assets include software, licences, customer relationship and other intangible assets. A core system is a large-scale software application that performs important strategic group objectives.

Development costs that are directly associated with identifiable and unique software controlled by the Group are recorded as intangible assets if the inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred.

Intangible assets are carried at cost less accumulated amortisation and impairment, if any. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

The amortisation of software and other intangible assets is calculated using the straight-line method to write off the cost of each asset to its residual value over its estimated useful life, as follows:

Core systems	8 years
Other software	4 years
Other intangible assets	5 years

Amortisation of the customer relationship is calculated using the diminishing balance method over its economic useful life. The economic useful life is the period over which the Group receives significant cash flows from the intangible assets.

Gains and losses on disposals are determined by comparing proceeds received in the transaction with the carrying amount of the assets. The resulting gains and losses are included as a net amount in Other net income.

### (19) Financial guarantees

In the ordinary course of business, the Group provides financial guarantees consisting of letters of credit and letters of guarantee. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. At the end of each reporting period, financial guarantees are measured in the financial statements at the higher of the amortised premium and the best estimates of expenditure required to settle any financial obligation arising as a result of the guarantee and are presented in Provisions. Fees are recognised in the statement of income in Fee and commission income. Any increase or decrease in the provision relating to financial guarantees is included in Impairment losses.

### (20) Employee benefits

#### *Retirement benefits*

Pensions are provided by the Czech Republic to resident employees financed by salary-based social security contributions of the employees and their employers.

Certain Group companies contribute to a defined contribution retirement benefit scheme for participating employees, in addition to the employer social security contributions required by the law in the Czech Republic. Contributions are charged to the statement of income as they are made.

#### *Termination benefits*

Employees dismissed by their employer are entitled to termination benefits equal to or less than three times the employees's month's average salary in accordance with the Czech employment law. Employees employed over ten years are entitled to additional termination benefits, which are scaled in accordance of the years of service. Termination benefits are recognised in the statement of income based on the approval of the restructuring programme implementation.

### (21) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

## (22) Income tax

There are two components of income tax expense: current and deferred. Current income tax expense approximates amounts to be paid or refunded for taxes for the appropriate period.

Deferred tax assets and liabilities are recognised due to differences between the tax bases of assets and liabilities and their respective carrying amounts in the financial statements. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss;
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not be reversed in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, except:

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss;
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will be reversed in the foreseeable future and the taxable profit will be available against which the temporary differences can be utilised.

All deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the deferred tax assets can be utilised. Deferred tax assets and liabilities are offset in the financial statements where a right of set-off exists.

Deferred tax related to the fair value movements of cash flow hedges and available-for-sale securities, which are charged or credited to OCI, is also credited or charged to OCI and is subsequently recognised in the statement of income together with the deferred gain or loss.

The Group records a net deferred tax asset under Deferred tax assets and a net deferred tax liability under Deferred tax liabilities for each separate consolidated entity.

## (23) Share capital and reserves

The issued capital (registered, subscribed and paid) as at the end of the reporting period is accounted for at an amount recorded in the Commercial register.

The statutory reserve fund is accumulated in compliance with the Statutes of the Bank and its use is limited by the Articles of association or Statutes. The fund is distributable based on the decision of the Board of Directors.

Dividends are recognised after they have been ratified by the resolution of the sole shareholder.

## (24) Fiduciary activities

The Group commonly acts in fiduciary activities that result in the holding or placing of assets on behalf of individuals and institutions. The assets and income arising thereon are excluded from these financial statements, as they are not assets of the Group.

## (25) Operating segments

Operating segments are components of the Group that engage in business activities from which they earn revenues and incur expenses and whose operating results are regularly reviewed on the Group level to assess their performance. Discrete information is available for each operating segment.

### 3. SCOPE OF CONSOLIDATION AND BUSINESS COMBINATIONS

The scope of the consolidation includes 30 companies. Ownership of the Group (%) in significant companies was as follows:

Name	Abbreviation	Country of incorporation	%	
			2016	2015
<b>Subsidiaries</b>				
Bankovní informační technologie, s.r.o.	BANIT	Czech Republic	100.00	100.00
Centrum Radlická a.s.	Centrum Radlická	Czech Republic	100.00	100.00
ČSOB Advisory, a.s.	ČSOB Advisory	Czech Republic	100.00	100.00
ČSOB Factoring, a.s.	ČSOB Factoring	Czech Republic	100.00	100.00
ČSOB Leasing, a.s.	ČSOB Leasing	Czech Republic	100.00	100.00
ČSOB Leasing pojišťovací makléř, s.r.o.	ČSOB Leasing pojišťovací makléř	Czech Republic	100.00	100.00
ČSOB Penzijní společnost, a. s., a member of the ČSOB group	ČSOB PS	Czech Republic	100.00	100.00
ČSOB Property fund, a.s.	ČSOB Property fund	Czech Republic	61.61	61.61
Hypoteční banka, a.s.	Hypoteční banka	Czech Republic	100.00	100.00
Merrion Properties s.r.o.	Merrion Properties	Czech Republic	61.61	61.61
Patria Corporate Finance, a.s.	Patria CF	Czech Republic	100.00	100.00
Patria Finance, a.s.	Patria Finance	Czech Republic	100.00	100.00
Patria Online, a.s.	Patria Online	Czech Republic	100.00	100.00
Radlice Rozvojová, a.s.	Radlice Rozvojová	Czech Republic	100.00	100.00
<b>Joint venture</b>				
Českomoravská stavební spořitelna, a.s.	ČMSS	Czech Republic	55.00	55.00
<b>Associates</b>				
ČSOB Asset Management, a.s., investment company	ČSOB AM	Czech Republic	40.08	40.08
ČSOB Pojišťovna, a.s., a member of the ČSOB holding	ČSOB Pojišťovna	Czech Republic	0.24	0.24

On 19 December 2014, the Group acquired 100% shares and 100% voting rights of Patria Online, a.s., which has full control over Patria Finance and Patria CF. The acquisition cost was CZK 1,180 m. Control over Patria Online was transferred to the Bank on 1 January 2015. Accordingly, the company started to be consolidated using the full method of consolidation from 1 January 2015. The Patria subgroup was included into the consolidated financial statements of the Group using the pooling of interest method.

Set out below is an analysis of the financial effect of the business combination of the Patria sub-group into the consolidated financial statements of the Group as at 1 January 2015:

### **Assets acquired and liabilities assumed**

(CZKm)	1.1.2015
<b>ASSETS</b>	
Financial assets held for trading	27
Available-for-sale financial assets	50
Loans and receivables	4,310
Tax assets	26
Property and equipment	12
Other assets	356
<b>Total assets</b>	<b>4,781</b>
<b>LIABILITIES</b>	
Financial liabilities at amortised cost	3,248
Tax liabilities	9
Provisions	10
Other liabilities	404
<b>Total liabilities</b>	<b>3,671</b>
<b>Total identifiable net assets</b>	<b>1,110</b>
Decrease of consolidated Retained earnings	70
<b>Cash consideration transferred</b>	<b>1,180</b>

There was no contingent consideration resulting from the transaction.

Loans and receivables mainly consisted of cash deposited on current and short term accounts in credit institutions. Financial liabilities at amortised cost represented cash deposits received from customers to be used for settlement of transactions with securities.

### **Cash flow on acquisition**

(CZKm)	1.1.2015
Net cash and cash equivalents acquired with the subsidiary	897
Cash paid	(1,180)
<b>Net cash flow on acquisition</b>	<b>(283)</b>

In accordance with the Group strategy, information and communication services were reintegrated from KBC Group Czech Branch back to ČSOB in 2015 (Note: 38). An agreement to acquire a part of business was concluded between ČSOB and the KBC Group and became effective in December 2015. According to the agreement, selected activities and processes of the KBC Group Czech Branch, including a number of employees (Note: 10), assets and liabilities related to the ICT function, were acquired by the Bank on 31 December 2015. Such a transfer represented a purchase of a part of the business by the Bank. The sales price which represented net cash outflow from the Group was determined on the basis of an independent expert appraisal and amounted to CZK 955 m. The difference between the purchase price of the business and carrying amount of the transferred assets and liabilities reached the amount of CZK 612 m and was recognised in the Group's Equity.

The acquisition was included into the consolidated financial statements of the Group using the pooling of interest method.

Set out below is an analysis of financial effect of the acquisition into the financial statements of the Group as at 31 December 2015:

**Assets acquired and liabilities assumed**

(CZKm)	31.12.2015
<b>ASSETS</b>	
Deferred tax assets (Note: 13)	144
Property and equipment (Note: 22)	504
Goodwill and other intangible assets (Note: 23)	2,317
Other assets	135
<b>Total assets</b>	<b>3,100</b>
<b>LIABILITIES</b>	
Financial liabilities at amortised cost	2,738
Other liabilities	19
<b>Total liabilities</b>	<b>2,757</b>
<b>Total identifiable net assets</b>	<b>343</b>
Decrease of Retained earnings	612
<b>Cash consideration (Note: 28)</b>	<b>955</b>

The cash consideration was settled in February 2016. There was no contingent consideration resulting from the transaction. The balance of Financial liabilities at amortised cost as at 31 December 2015 included CZK 1,136 m of cash equivalents.

Based on the Agreement on the exercise of voting rights, the Group is entitled to a total of 40% of the voting rights in ČSOB Pojišťovna. Thus, ČSOB Pojišťovna is still assessed to be an associated company of the Bank (Note: 19).

Based on the Agreement on the exercise of voting rights, the Group is entitled to a total of 95.67% of the voting rights in ČSOB Property fund and Merrion Properties (special purpose entity fully owned by ČSOB Property Fund). Both these two subsidiaries are consolidated using full method of consolidation. Non-controlling interest represents the 38.39% portion of the net profit and the net assets of ČSOB Property fund and Merrion Properties not owned by the Group.

Based on the company statutes, the Group controls ČMSS jointly with the owner of the remaining 45% share. Therefore, the entity is classified as a joint venture.

Ownership in other companies corresponds with the share of voting rights.

## 4. SEGMENT INFORMATION

The Group's primary segment reporting is by customer segment.

The Group has five reportable segments, as described below, which are the Group's strategic business units. The strategic business units offer different products and services, and are managed separately based on the Group's management and internal reporting (controlling) structure. For each of the strategic business units, the Group's management reviews internal management reports on a quarterly/monthly basis.

Management monitors the operating result of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects is measured differently from operating profit or loss in the separate financial statements. Income tax is allocated to operating segments, but is managed on a Group basis.

### Definitions of customer operating segments:

**Retail:** Private individuals and entrepreneurs, except of private banking customers that are reported as a part of Relationship services. This segment contains customers' deposits, consumer loans, overdrafts, payment solutions including payment cards and other transactions and balances with retail customers. Margin income from operations with retail clients on the financial market is also allocated to this segment (i.e. a margin from spot operations, hedging of foreign currency transactions and trading with bonds).

**Relationship services:** Corporate companies with a turnover of greater than CZK 300 m, SME companies with a turnover of less than CZK 300 m, private banking customers with financial assets above CZK 10 m, financial and public sector institutions. This segment contains customers' deposits, loans, overdrafts, payment solutions including payment cards, leasing and other transactions and balances with corporate, SME customers and private banking customers. Margin income from the operations with corporate, SME clients and private banking clients on the financial market is also allocated to this segment (i.e. a margin from spot operations, hedging of foreign currency transactions or trading with bonds).

**Financial markets:** This segment contains investment products and services to institutional investors and intermediaries and fund management activities and trading included in dealing services.

**Specialised banking:** This segment contains mortgages, building savings, building savings loans, pension funds, mutual funds and asset management.

**Group Centre:** The Group Centre segment consists of positions and results of Asset Liability Management (ALM), the Group's yield on real equity consisting of an interest charge on capital provided to subsidiaries which are a part of the Relationship services and Specialised banking segment, the results of the reinvestment of free equity of ČSOB and items not directly attributable to other segments.

In 2016, non-manageable costs (i.e. Internal audit, Human Resources, Finance and other related Common Costs) representing a part of other operating expenses previously allocated into segments started to be reported at Group Centre. Comparative figures in the Statement of income for 2015 have been reclassified.

## Segment reporting information by customer segments for 2016

(CZK m)	Retail	Relationship services	Financial markets	Specialised banking	Group Centre	Total
<b>Statement of income</b>						
Net interest income	7,338	8,387	(36)	4,842	1,704	<b>22,235</b>
Net fee and commission income	2,051	2,525	318	1,035	289	<b>6,218</b>
Dividend income	-	-	-	1	7	<b>8</b>
Net gains from financial instruments at fair value through profit or loss	511	1,519	912	34	171	<b>3,147</b>
Net realised gains on available-for- sale financial assets	-	-	-	(1)	1,295	<b>1,294</b>
Other net income	36	484	-	72	549	<b>1,141</b>
<b>Operating income</b>	<b>9,936</b>	<b>12,915</b>	<b>1,194</b>	<b>5,983</b>	<b>4,015</b>	<b>34,043</b>
<i>of which:</i>						
External operating income	4,332	11,062	1,194	7,681	9,774	34,043
Intersegment operating income	5,604	1,853	-	(1,698)	(5,759)	-
Depreciation and amortisation	(37)	(37)	-	(107)	(1,087)	<b>(1,268)</b>
Other operating expenses	(6,774)	(4,395)	(233)	(1,377)	(1,604)	<b>(14,383)</b>
<b>Operating expenses</b>	<b>(6,811)</b>	<b>(4,432)</b>	<b>(233)</b>	<b>(1,484)</b>	<b>(2,691)</b>	<b>(15,651)</b>
Impairment losses - additions	(363)	(1,893)	-	(592)	(456)	<b>(3,304)</b>
Impairment losses - reversals	450	1,223	-	543	380	<b>2,596</b>
<b>Impairment losses</b>	<b>87</b>	<b>(670)</b>	<b>-</b>	<b>(49)</b>	<b>(76)</b>	<b>(708)</b>
Share of profit of associates and joint ventures	-	-	-	696	-	<b>696</b>
<b>Profit before tax</b>	<b>3,212</b>	<b>7,813</b>	<b>961</b>	<b>5,146</b>	<b>1,248</b>	<b>18,380</b>
Income tax expense	(644)	(1,499)	(182)	(799)	(108)	<b>(3,232)</b>
<b>Segment profit</b>	<b>2,568</b>	<b>6,314</b>	<b>779</b>	<b>4,347</b>	<b>1,140</b>	<b>15,148</b>
<b>Attributable to:</b>						
Owners of the parent	2,568	6,314	779	4,347	1,133	<b>15,141</b>
Non-controlling interest	-	-	-	-	7	<b>7</b>
<b>Assets and liabilities</b>						
Segment assets	23,737	277,366	21,231	257,809	500,375	<b>1,080,518</b>
Investment in associates and joint ventures	-	-	-	-	4,957	<b>4,957</b>
Non-current assets held-for-sale	-	17	-	-	35	<b>52</b>
<b>Total assets</b>	<b>23,737</b>	<b>277,383</b>	<b>21,231</b>	<b>257,809</b>	<b>505,367</b>	<b>1,085,527</b>
<b>Total liabilities</b>	<b>365,420</b>	<b>320,913</b>	<b>40,981</b>	<b>22,155</b>	<b>247,323</b>	<b>996,792</b>
<b>Capital expenditure</b>	<b>254</b>	<b>4,016</b>	<b>-</b>	<b>284</b>	<b>1,439</b>	<b>5,993</b>



## Segment reporting information by customer segments for 2015

(CZK m)	Retail	Relationship services	Financial markets	Specialised banking	Group Centre	Total
<b>Statement of income</b>						
Net interest income	7,484	8,214	208	4,630	1,767	<b>22,303</b>
Net fee and commission income	2,393	2,461	288	923	326	<b>6,391</b>
Dividend income	-	-	-	2	6	<b>8</b>
Net gains / (losses) from financial instruments at fair value through profit or loss	457	1,396	808	35	(44)	<b>2,652</b>
Net realised gains on available-for- sale financial assets	-	-	-	-	326	<b>326</b>
Other net income	33	444	-	100	285	<b>862</b>
<b>Operating income</b>	<b>10,367</b>	<b>12,515</b>	<b>1,304</b>	<b>5,690</b>	<b>2,666</b>	<b>32,542</b>
<i>of which:</i>						
External operating income	4,237	10,855	1,304	7,699	8,447	32,542
Intersegment operating income	6,130	1,660	-	(2,009)	(5,781)	-
Depreciation and amortisation	(36)	(56)	-	(72)	(453)	<b>(617)</b>
Other operating expenses	(7,369)	(4,406)	(259)	(1,217)	(1,819)	<b>(15,070)</b>
<b>Operating expenses</b>	<b>(7,405)</b>	<b>(4,462)</b>	<b>(259)</b>	<b>(1,289)</b>	<b>(2,272)</b>	<b>(15,687)</b>
Impairment losses - additions	(475)	(1,352)	-	(890)	(68)	<b>(2,785)</b>
Impairment losses - reversals	328	868	-	447	61	<b>1,704</b>
<b>Impairment losses</b>	<b>(147)</b>	<b>(484)</b>	<b>-</b>	<b>(443)</b>	<b>(7)</b>	<b>(1,081)</b>
Share of profit of associates and joint ventures	-	-	-	687	-	<b>687</b>
<b>Profit before tax</b>	<b>2,815</b>	<b>7,569</b>	<b>1,045</b>	<b>4,645</b>	<b>387</b>	<b>16,461</b>
Income tax (expense) / benefit	(535)	(1,438)	(199)	(723)	423	<b>(2,472)</b>
<b>Segment profit</b>	<b>2,280</b>	<b>6,131</b>	<b>846</b>	<b>3,922</b>	<b>810</b>	<b>13,989</b>
<b>Attributable to:</b>						
Owners of the parent	2,280	6,131	846	3,922	831	<b>14,010</b>
Non-controlling interest	-	-	-	-	(21)	<b>(21)</b>
<b>Assets and liabilities</b>						
Segment assets	19,721	266,137	30,435	232,593	402,106	<b>950,992</b>
Investment in associates and joint ventures	-	-	-	-	4,970	<b>4,970</b>
Non-current assets held-for-sale	-	297	-	-	66	<b>363</b>
<b>Total assets</b>	<b>19,721</b>	<b>266,434</b>	<b>30,435</b>	<b>232,593</b>	<b>407,142</b>	<b>956,325</b>
<b>Total liabilities</b>	<b>336,713</b>	<b>294,546</b>	<b>30,061</b>	<b>22,245</b>	<b>182,041</b>	<b>865,606</b>
<b>Capital expenditure</b>	<b>61</b>	<b>1,536</b>	<b>-</b>	<b>219</b>	<b>259</b>	<b>2,075</b>

Interest income and interest expense are not presented separately since the Group assesses the performance of the segments primarily on the basis of the net interest income.

Intersegment transactions are transactions conducted between the different primary segments on an arm's length basis.

The Group operates predominantly in the Czech Republic.



## 5. INTEREST INCOME

(CZKm)	2016	2015
Cash balances with central banks	53	19
Loans and receivables		
Credit institutions	364	381
Other than credit institutions	15,359	15,924
Available-for-sale financial assets	1,486	1,716
Held-to-maturity investments	5,091	5,383
Financial assets held for trading (Note: 8)	334	357
Financial assets designated at fair value through profit or loss (Note: 8)	-	87
Derivatives used as economic hedges (Note: 8)	128	144
Derivatives used for hedging (Note: 8)	1,854	1,569
Negative interest from financial liabilities measured at amortised cost	349	-
Negative interest from financial liabilities measured at fair value (Note: 8)	25	-
	<b>25,043</b>	<b>25,580</b>

## 6. INTEREST EXPENSE

(CZKm)	2016	2015
Financial liabilities at amortised cost		
Central banks	-	2
Credit institutions	206	210
Other than credit institutions	714	1,155
Debt instruments in issue	342	369
Discount amortisation on other provisions (Note: 29)	3	3
Financial liabilities held for trading (Note: 8)	413	280
Derivatives used as economic hedges (Note: 8)	76	202
Derivatives used for hedging (Note: 8)	1,050	1,056
Negative interest from financial assets measured at fair value (Note: 8)	4	-
	<b>2,808</b>	<b>3,277</b>

## 7. NET FEE AND COMMISSION INCOME

(CZKm)	2016	2015
<b>Fee and commission income</b>		
Payment services	5,274	5,613
Administration of credits	1,954	1,916
Collective investments	664	768
Securities	374	427
Custody	185	178
Asset management	79	67
Other	1,047	858
	<b>9,577</b>	<b>9,827</b>
<b>Fee and commission expense</b>		
Payment services	1,479	1,750
Retail service fees	1,017	986
Commissions to agents	126	58
Other	737	642
	<b>3,359</b>	<b>3,436</b>
<b>Net fee and commission income</b>	<b>6,218</b>	<b>6,391</b>

## 8. NET GAINS FROM FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS AND FOREIGN EXCHANGE

Net gains from financial instruments at fair value through profit or loss, as reported in the statement of income, do not include net interest income recognised on financial assets and financial liabilities at fair value through profit or loss. Net gains from financial instruments at fair value through profit or loss and the related net interest income are set out in the table below to provide a fuller presentation of the net result from financial instruments at fair value through profit or loss of the Group:

(CZKm)	2016	2015
<b>Net gains from financial instruments at fair value through profit or loss and foreign exchange- as reported</b>	<b>3,147</b>	<b>2,652</b>
Net interest income (Notes: 5, 6)	798	619
	<b>3,945</b>	<b>3,271</b>
<b>Financial instruments held for trading and derivatives used for hedging</b>		
Interest rate contracts	1,290	799
Foreign exchange	849	3,416
Equity contracts	173	(58)
Commodity contracts	15	22
	<b>2,327</b>	<b>4,179</b>
<b>Financial instruments designated at fair value through profit or loss</b>		
Financial assets designated at fair value through profit or loss	5	34
Financial liabilities designated at fair value through profit or loss	(73)	-
	<b>(68)</b>	<b>34</b>
Foreign exchange differences	1,686	(942)
<b>Financial instruments at fair value through profit or loss and foreign exchange</b>	<b>3,945</b>	<b>3,271</b>

## 9. OTHER NET INCOME

(CZKm)	2016	2015
ICT services	551	-
Net operating leasing and rental income	340	383
Services provided to the parent and to entities under common control (excluding income from ICT services)	125	242
Other services provided by ČSOB Leasing	56	51
Net gain on disposal of loans and receivables	1	32
Net loss on disposal of liabilities at amortised cost	-	(23)
Net (loss) / gain on disposal of property and equipment	(9)	11
Net (increase) / decrease in provisions for legal issues and other losses	(72)	41
Other	149	125
	<b>1,141</b>	<b>862</b>

After the reintegration of ICT function back to ČSOB (Note: 3), the Group started from 1 January 2016, to provide information and communication services to other entities under common control from. The related income is presented as part of Other net income under ICT services.

## 10. STAFF EXPENSES

(CZKm)	2016	2015
Wages and salaries	5,327	5,010
Salaries and other short-term benefits of top management	90	97
Social security charges	1,776	1,532
<i>of which pension security charges (obligatory)</i>	<i>1,073</i>	<i>916</i>
Pension (voluntary) and similar expenses	133	123
Additions of provisions for Restructuring programme (Note: 29)	-	100
Other	184	145
	<b>7,510</b>	<b>7,007</b>

### Number of personnel of the Group

The number (in full-time equivalents) of personnel of the Group was 8,232 at 31 December 2016 (31 December 2015: 8,203).

In 2015, information and communication services were reintegrated from KBC Group Czech Branch back to ČSOB (Note: 3). As a result, 750 employees of the KBC Group were transferred to the Bank as at 31 December 2015.

### Management bonus scheme

Included within Salaries and other short-term benefits of top management are salaries and remuneration of the Members of the Board of Directors. Salaries and remuneration of the Members of the Board of Directors, as well as the remuneration principles and structure, are subject to the approval of the Supervisory Board.

Following the change in legislation, a new bonus scheme for selective employees was launched in 2011. Half of the bonus is provided in a non-cash instrument Virtual investment certificate (VIC) as an equivalent of the 10-year government bond. The payment of half of the bonus (both cash and non-cash portion) is deferred for up to the next three years following the initial assignment of the benefit.

### Retirement benefits

The Group provides its employees (including top management) with a voluntary defined contribution retirement scheme. Participating employees can contribute 1% or 2% of their salaries mainly to Transformed fund Stabilita or to participation funds managed by ČSOB PS and by other pension companies approved by the Ministry of Finance of the Czech Republic (MF CZ), with an additional contribution of the Group of 2% or 3% of their salaries, respectively.

### Termination benefits

Employees dismissed by their employer according to Czech employment law are entitled to termination benefits equal to or less than three times the employee's monthly average salary. Additional termination benefits are granted to employees who were employed between 10-15 years (2 times the month's average salary), 15-20 years (2.5 times the month's average salary), 20-25 years (3 times the month's average salary), 25-30 years (4 times the month's average salary), 30-35 years (5 times the month's average salary) and over 35 years (6 times the month's average salary).

In the case of contract termination, the members of the Board of Directors are entitled to receive an amount of 0 to 12 monthly salaries as termination benefits (according to conditions of individual contracts). In 2016 and 2015, no such compensation was paid.

## 11. GENERAL ADMINISTRATIVE EXPENSES

(CZKm)	2016	2015
Information technologies	2,244	3,394
Marketing	645	573
Contribution to the Single Resolution Mechanism	603	-
Rental expenses on land and buildings - minimum lease payments	571	585
Professional fees	498	448
Other building expenses	469	503
Communication	370	329
Administration	223	187
Retail service fees	198	237
Deposit insurance premium and contribution to the Securities Traders Guarantee Fund	163	949
Payment cards and electronic banking	152	142
Travel and transportation	151	150
Training	78	80
Insurance	36	36
Car expenses	21	28
Other	451	422
	<b>6,873</b>	<b>8,063</b>

Until 31 December 2015, the Group was outsourcing information and communication services from KBC Group Czech Branch. As a result of the reintegration of the ICT function back to ČSOB Bank from 1 January 2016 (Note: 3), the structure of operating expenses has changed. Expenses related to ICT services are included under General administrative expenses fully in 2015, while in 2016, a portion of ICT related expenses is reported as part of Staff expenses and Depreciation and amortisation.

Information technology expenses include CZK Nil in 2016 (2015: CZK 1,943 m) representing minimum lease payments related to rental expenses of information technologies from KBC Group Czech Branch.

Based on the EU Directive and the related binding Delegated Act, banks in the EU are obliged to contribute to the Single Resolution Mechanism (SRM) from 2015. The rules were incorporated into the Czech law in December 2015 with the effective day 1 January 2016. The new law reflects the definition of SRM contributions and the changes in the deposit insurance premium calculation. In April 2016, the Group obtained the final calculation of the contribution to the local resolution fund from the Czech National Bank amounting to CZK 603 m.

## 12. IMPAIRMENT LOSSES

(CZKm)	2016	2015
Impairment of loans and receivables (Notes: 18, 33)	(670)	(968)
Provisions for loan commitments and guarantees (Notes: 29, 33)	53	(15)
Impairment of property, plant and equipment (Notes: 22, 33)	(13)	(1)
Impairment of available-for-sale financial assets (Notes: 17, 33)	(2)	(24)
Impairment of goodwill (Notes: 23, 33)	-	(66)
Impairment of intangible assets (Note: 23, 33)	(74)	-
Impairment of non-current assets held-for-sale (Notes: 24, 33)	-	(9)
Impairment of other assets (Note: 33)	(2)	2
	<b>(708)</b>	<b>(1,081)</b>

### 13. INCOME TAX

The components of income tax expense for the years ended 31 December 2016 and 2015 are as follows:

(CZKm)	2016	2015
Current tax expense	3,167	2,424
Net provisions for tax disputes	149	-
Previous year over accrual of current tax	(9)	(9)
Deferred tax expense relating to the origination and reversal of temporary differences	(75)	57
	<b>3,232</b>	<b>2,472</b>

A reconciliation between the tax expense and the accounting profit multiplied by the domestic tax rate for the years ended 31 December 2016 and 2015 is as follows:

(CZKm)	2016	2015
Profit before taxation	18,380	16,461
Applicable tax rates	19%	19%
Taxation at applicable tax rates	3,492	3,128
Net provisions for tax disputes	149	-
Previous year over accrual of current tax	(9)	(9)
Tax effect of non-taxable income	(809)	(701)
Tax effect of non-deductible expenses	443	89
Unused tax losses applicable in next periods	(34)	(35)
	<b>3,232</b>	<b>2,472</b>

The applicable tax rate for 2016 was 19% (2015: 19%).

Included in non-taxable income is interest income accrued on tax-free financial investments.

Deferred income taxes are calculated on all temporary differences under the liability method using the income tax rate of 19%.

The movement on the deferred income tax account is as follows:

(CZKm)	2016	2015
<b>At 1 January</b>	<b>(2,010)</b>	<b>(2,180)</b>
Statement of income	75	(57)
Available-for-sale securities (Note: 31)		
Fair value remeasurement	111	(164)
Transfer to net profit	285	110
Cash-flow hedges (Note: 31)		
Fair value remeasurement	29	(15)
Transfer to net profit (Note: 20)	120	152
Other	(7)	144
<b>At 31 December</b>	<b>(1,397)</b>	<b>(2,010)</b>

Deferred tax asset and liability are attributable to the following items:

(CZKm)	2016	2015
<b>Deferred tax asset</b>		
Temporary difference resulting from tax depreciation	65	59
Allowances for credit losses	46	52
Unused tax losses applicable in the next periods	31	22
Initial fee income	21	-
Employee benefits	7	7
Impairment of tangible and intangible assets	5	4
Provisions	2	2
Other temporary differences	2	6
	<b>179</b>	<b>152</b>

(CZKm)	2016	2015
<b>Deferred tax liability</b>		
Temporary difference resulting from tax depreciation	682	656
Available-for-sale securities	618	969
Cash-flow hedging derivatives	521	682
Amortisation of goodwill	478	442
Initial fee expense	204	99
Finance lease valuation	86	75
Held-to-maturity investments - bonds reclassified from Available-for-sale securities (Note: 17)	72	110
Impairment of tangible and intangible assets	(17)	(2)
Revaluation of financial assets and liabilities at fair value through profit or loss	(21)	3
Impairment losses on financial investments	(26)	(26)
Loans and receivables- bonds reclassified from Available-for-sale securities (Note: 17)	(73)	(78)
Provisions	(110)	(112)
Temporary difference resulting from tax depreciation related to acquisition of ICT function (Note: 3)	(134)	(144)
Allowances for credit losses	(168)	(124)
Legal claims	(202)	(93)
Employee benefits	(265)	(280)
Other temporary differences	(69)	(15)
	<b>1,576</b>	<b>2,162</b>

The deferred tax benefit / (charge) in the statement of income comprises of the following temporary differences:

(CZKm)	2016	2015
Temporary difference resulting from tax depreciation	(20)	(49)
Employee benefits	(15)	3
Initial fee income	(84)	(9)
Available-for-sale securities	8	(16)
Finance lease valuation	(11)	26
Provisions	(2)	12
Amortisation of goodwill	(36)	(36)
Revaluation of financial assets and liabilities at fair value through profit or loss	24	(12)
Allowances for credit losses	38	3
Legal claims	109	15
Unused tax losses applicable in the next periods	9	22
Impairment of tangible and intangible assets	16	(18)
Temporary difference resulting from tax depreciation related to acquisition of ICT function	(10)	-
Other temporary differences	49	2
	<b>75</b>	<b>(57)</b>

The Group management believes it is probable that the Group will fully realise its gross deferred income tax assets based upon the Group's current and expected future level of taxable profits and the expected offset within each Group company from gross deferred income tax liabilities. The Group can carry forward tax loss for up to 5 years from its initial recognition.

#### 14. DIVIDENDS PAID

Dividends are not accounted for until they have been ratified by a resolution of the sole shareholder on a profit distribution. The decision of a profit allocation for 2016 has not been taken before the date of issue of the financial statements.

Based on a sole shareholder decision from 22 April 2016, a dividend of CZK 50.49 per share was paid for 2015, representing a total dividend of CZK 14,781 m.

Based on a sole shareholder decision from 9 April 2015, a dividend of CZK 45.12 per share was paid for 2014, representing a total dividend of CZK 13,208 m.

#### 15. CASH AND BALANCES WITH CENTRAL BANKS

(CZKm)	2016	2015
Cash (Note: 33)	9,077	9,522
Mandatory minimum reserves (Notes: 34, 40.2)	10,782	9,727
Other balances with central banks (Notes: 33, 34, 40.2)	37,215	98,038
	<b>57,074</b>	<b>117,287</b>

The Czech National Bank (CNB) pays interest on the mandatory minimum reserve balances based on the official CNB two-week repo rate. The Group is obliged to keep the balance of mandatory minimum reserve, however it is allowed to use the reserve for a liquidity management purposes during the month. Given that fact, mandatory minimum reserve is assessed to be a cash equivalent by the Group.

Other balances with central banks contain overnight loans provided to central bank in the amount of CZK 33,900 m at 31 December 2016 (31 December 2015: CZK 94,900 m).

## 16. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

(CZKm)	2016	2015
<b>Financial assets held for trading</b>		
Loans and advances		
Reverse repo transactions (Note: 36)	155	-
Money market placements	15	-
Debt instruments		
General government	4,527	13,270
Credit institutions	2,446	3,616
Corporate	247	1,198
Equity securities		
Corporate	1	6
Derivative contracts (Note: 20)		
Trading derivatives	12,167	10,935
Derivatives used as economic hedges	450	469
	<b>20,008</b>	<b>29,494</b>
<b>Financial assets designated at fair value through profit or loss</b>		
Debt instruments		
Credit institutions	-	15
	<b>-</b>	<b>15</b>
<b>Financial assets at fair value through profit or loss</b>	<b>20,008</b>	<b>29,509</b>

Included within Financial assets at fair value through profit or loss are debt securities of CZK 568 m (2015: CZK Nil) pledged as collateral in repo transactions or securities lending. Under the terms and conditions of the pledge in repo transactions or securities lending, the transferee has a right to sell or repledge the collateral.

Included in Financial assets designated at fair value through profit or loss are debt securities recorded at fair value to reduce the accounting mismatch that would otherwise arise from measuring these assets or recognising the gains and losses from them on a different basis.

## 17. FINANCIAL INVESTMENTS

(CZKm)	2016	2015
<b>Available-for-sale financial assets</b>		
Debt securities		
General government	39,585	38,944
Credit institutions	16,510	19,453
Corporate	427	234
Equity securities		
Corporate	416	1,330
	<b>56,938</b>	<b>59,961</b>
<b>Held-to-maturity investments</b>		
Debt securities		
General government	130,453	133,705
Credit institutions	1,393	1,395
Corporate	833	1,333
	<b>132,679</b>	<b>136,433</b>
<b>Financial investments</b>	<b>189,617</b>	<b>196,394</b>



Included within Financial investments are debt securities pledged as collateral in repo transactions in the amount of CZK 9,578 m (2015: CZK Nil) or securities lending in the amount of CZK 9,552 m (2015: CZK 3,489 m) and debt securities of CZK 12,601 m (2015: CZK 7,831 m) pledged as collateral of term deposits and financial guarantees. Under the terms and conditions of the pledge in repo transactions or securities lending, the transferee has a right to sell or repledge the collateral.

In June 2013, a part of the portfolio of debt sovereign bonds was transferred from Available-for-sale financial assets to the portfolio of Held-to-maturity investments in the fair value of CZK 14,513 m, as a result of the change of the Bank's intention to hold the bonds to maturity. Unrealised gains from the bonds in the amount of CZK 1,224 m at the date of the transfer remained a part of the Available-for-sale reserve and are amortised in interest income over the remaining maturity of the bonds (2012: CZK 1,412 m).

Set out below is a set of information relating to the Group's financial instruments reclassified from the Available-for-sale financial assets to the Held-to-maturity investments:

(CZK m)	2016	2015
Carrying value	8,552	13,446
Fair value	9,396	14,445
Net gain (before tax) that would have been recognised in the Statement of comprehensive income after the date of reclassification if the Group had not reclassified the assets	(155)	(55)
Interest income (before tax) recorded on reclassified assets after date of reclassification	405	446

As assessed at the date of reclassification, an expected undiscounted cash recoveries amounted to CZK 15,135 m and the level of anticipated average effective interest rate (EIR) over the remaining life of the assets is at 3.5%.

As at 31 December 2015, the Group reported a share in Visa Europe in the amount of CZK 1,288 m based on the model, which reflected the expected set up of the announced merger of Visa Inc. and Visa Europe Ltd. In June 2016, the takeover of Visa Europe Ltd. by Visa Inc. took place. According to the final approved structure of the transaction, the sales price is to be settled in three tranches: cash payment, transfer of preferred shares of Visa Inc. and further cash payment in 2019.

In June 2016, the Group received a cash consideration in the amount of CZK 977 m as the first tranche.

The Group acquired series C preferred shares of Visa Inc. as the second tranche. Accordingly, the Group derecognised the original share in Visa Europe and recognised the share in Visa Inc. classified as Available-for-sale financial asset in the amount of CZK 251 m at 30 June 2016. The preferred shares of Visa Inc. can only be sold, with certain restrictions, to other holders of Visa Inc. preferred shares and will be fully converted to Visa Inc. listed shares after 12 years.

Furthermore, the Group will receive a deferred cash payment of CZK 84 m as the third tranche, if the Group keeps holding of the shares for at least 3 years past the merger.

As a result of the transaction, the Group recognised a gain of CZK 1,295 m reported in the consolidated statement of income for 2016 as a Net realised gain on available-for-sale financial assets. The deferred cash payment of CZK 76 m will be amortized over the 3 years period.

The following table shows a reconciliation of the cumulative impairment losses on financial investments for 2015 and 2016:

(CZKm)	Available-for-sale financial assets Equity securities	Total
<b>At 1 January 2015</b>	<b>79</b>	<b>79</b>
Increase	24	24
<b>At 31 December 2015</b>	<b>103</b>	<b>103</b>
Increase	2	2
Utilisation	(29)	(29)
<b>At 31 December 2016</b>	<b>76</b>	<b>76</b>

## 18. LOANS AND RECEIVABLES

(CZKm)	2016	2015
<b>Analysed by category of borrower</b>		
Central banks	235,003	70,001
General government	6,446	9,009
Credit institutions	11,209	16,046
Other legal entities	220,073	207,109
Private individuals	320,558	288,242
Gross loans	793,289	590,407
Allowance for impairment losses	(10,066)	(10,959)
	<b>783,223</b>	<b>579,448</b>

Balances with central banks contain reverse repo transactions provided to central bank in the amount of CZK 235,003 m at 31 December 2016 (31 December 2015: CZK 70,001 m).

Finance lease receivables may be analysed as follows:

(CZKm)	2016	2015
<b>Total amount of the future minimum lease payments</b>	<b>16,059</b>	<b>14,990</b>
At not more than one year	4,267	4,051
At more than one but not more than five years	8,918	8,640
At more than five years	2,874	2,299
Unearned future finance income on finance leases	(645)	(760)
<b>Present value of the future minimum lease payments</b>	<b>15,414</b>	<b>14,230</b>
At not more than one year	4,096	3,846
At more than one but not more than five years	8,560	8,202
At more than five years	2,758	2,182
Accumulated allowance for uncollectible minimum lease payments receivable	(229)	(207)

Finance lease receivables are collateralised by the leased items. Leasing companies maintain legal ownership of the respective collateral.

The following tables show a reconciliation of the allowances for impairment losses on loans and receivables for 2015 and 2016 by classes of financial instruments and by individual and collective impairment:

(CZKm)	General government	Credit Institutions	Other legal entities	Private Individuals	Total
<b>At 1 January 2015</b>	<b>7</b>	<b>13</b>	<b>6,012</b>	<b>5,166</b>	<b>11,198</b>
Net increase in allowances for credit losses (Note: 12)	(4)	(13)	521	464	968
Write-offs	-	-	(470)	(735)	(1,205)
Foreign currency translation	-	-	(4)	2	(2)
<b>At 31 December 2015</b>	<b>3</b>	<b>-</b>	<b>6,059</b>	<b>4,897</b>	<b>10,959</b>
Net increase in allowances for credit losses (Note: 12)	7	1	609	53	670
Write-offs	-	-	(830)	(733)	(1,563)
Foreign currency translation	-	-	(2)	2	-
<b>At 31 December 2016</b>	<b>10</b>	<b>1</b>	<b>5,836</b>	<b>4,219</b>	<b>10,066</b>

(CZKm)	Individual impairment	Collective impairment	Total
<b>At 1 January 2015</b>	<b>10,441</b>	<b>757</b>	<b>11,198</b>
Increase in allowances for credit losses (Note: 12)	2,224	414	2,638
Decrease in allowances for credit losses (Note: 12)	(1,422)	(248)	(1,670)
Write-offs	(1,202)	(3)	(1,205)
Transfers	(55)	55	-
Foreign currency translation	(2)	-	(2)
<b>At 31 December 2015</b>	<b>9,984</b>	<b>975</b>	<b>10,959</b>
Increase in allowances for credit losses (Note: 12)	2,287	408	2,695
Decrease in allowances for credit losses (Note: 12)	(1,680)	(345)	(2,025)
Write-offs	(1,563)	-	(1,563)
Transfers	(20)	20	-
Foreign currency translation	2	(2)	-
<b>At 31 December 2016</b>	<b>9,010</b>	<b>1,056</b>	<b>10,066</b>

As at 31 December 2016, the Group possessed assets (mainly cars related to leased assets) with an estimated value of CZK 17 m (2015: CZK 19 m), which the Group is in the process of selling (Note: 24).

## 19. INVESTMENT IN ASSOCIATES AND JOINT VENTURES

The investment in ČMSS is a strategic interest of the Bank involved in the business of providing building savings loans and accepting building savings deposits. With regard to the characteristics of its business, ČMSS is exposed to credit risk. The risk is managed on the level of ČMSS while adopting the same policies and processes of credit risk management as used by the Group. Except for loan commitments given in the amount of CZK 2,786 m equivalent to the Group's share (31 December 2015: CZK 2,713 m) ČMSS had no other contingent liabilities.

As a result of the sale of significant part the ČSOB's participation in ČSOB Pojišťovna in 2012, the Group's ownership interest in ČSOB Pojišťovna is 0.24% while an amount of voting rights of ČSOB remains at 40% (Note: 3).

Effective from January 2012, ČSOB lost control in ČSOB AM but retained significant influence and therefore ČSOB AM is considered to be an associated company (Note: 3). ČSOB AM is a strategic interest of the Bank specialised in providing its clients with investment services of asset management and collective investment services, including management of local mutual funds.

The following table illustrates the summarised financial information of the investment in the associates and joint ventures:

(CZKm)	ČMSS		ČSOB AM		ČSOB Pojišťovna	
	2016	2015	2016	2015	2016	2015
<b>The associate's and joint venture's assets and liabilities</b>						
Assets	149,536	153,215	721	593	42,220	41,021
of which current assets	15,656	15,362	98	109	1,940	1,807
Liabilities	140,775	144,437	400	263	38,117	37,050
of which current liabilities	896	1,021	400	263	1,724	1,507
<b>Net assets</b>	<b>8,761</b>	<b>8,778</b>	<b>321</b>	<b>330</b>	<b>4,103</b>	<b>3,971</b>
<b>Carrying amount of the investment</b>	<b>4,819</b>	<b>4,828</b>	<b>128</b>	<b>132</b>	<b>10</b>	<b>10</b>
<b>The associate's and joint venture's results</b>						
Interest income	4,874	5,394	3	-	882	921
Interest expense	(2,410)	(2,819)	-	-	(172)	(168)
Total revenues	3,024	3,199	376	384	13,325	12,296
Depreciation and amortisation	(248)	(154)	(7)	(7)	(45)	(44)
Income tax expense	(270)	(256)	(37)	(39)	(190)	(163)
Profit for the year	1,145	1,123	159	168	869	716
Profit for the year – share of the Group	630	618	64	67	2	2
Dividend – share of the Bank	607	638	41	25	2	2
Other comprehensive income	(32)	(17)	-	-	-	-
Total comprehensive income	598	601	64	67	2	2

## 20. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative instruments are utilised by the Group for trading and hedging purposes. Derivative instruments include swaps, forwards and option contracts. A swap agreement is a contract between two parties to exchange cash flows based on specified underlying notional amounts, assets and/or indices. Forward contracts are agreements to buy or sell a quantity of a financial instrument, index, currency or commodity at a predetermined future date and rate or price. An option contract is an agreement that conveys to the purchaser the right, but not the obligation, to buy or sell a quantity of a financial instrument, index, currency or commodity at a predetermined rate or price at a time or during a period in the future.

### Credit risk associated with derivative financial instruments

By using derivative instruments, the Group is exposed to credit risk in the event of non-performance by counterparties in respect of derivative instruments. If a counterparty fails to perform, credit risk is equal to the positive fair value of the derivatives with that counterparty. When the fair value of a derivative is positive, the Group bears the risk of loss; conversely, when the fair value of a derivative is negative, the counterparty bears the risk of loss (or credit risk). The Group minimises credit risk through credit approvals, limits and monitoring procedures. Furthermore, the Group obtains collateral where appropriate and uses bilateral master netting arrangements.

All derivatives are traded over-the-counter.

The maximum credit risk on the Group's outstanding non-credit derivatives is measured as the cost of replacing their cash flows with positive fair value if the counterparties default, less the effects of bilateral netting arrangements and collateral held. The Group's actual credit exposures are less than the positive fair value amounts shown in the derivative tables below as netting arrangements and collateral have not been considered.

## Trading derivatives

The Group's trading activities primarily involve providing various derivative products to its customers and managing trading positions for its own account. Trading derivatives also include those derivatives which are used for asset and liability management (ALM) purposes to manage the interest rate position of the Banking Book (positions managed by ALM) and which do not meet the criteria of hedge accounting; still they are used as natural or economic hedges.

The contract or notional amounts and positive and negative fair values of the Group's outstanding derivative trading positions as at 31 December 2016 and 2015 are set out in the table below. The contract or notional amounts represent the volume of outstanding transactions at a point in time; they do not represent the potential for gain or loss associated with the market risk or credit risk of such transactions.

### Trading positions

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Interest rate related contracts</b>						
Swaps	551,218	8,822	10,109	447,435	8,108	10,073
Forwards	16,700	2	-	39,592	6	1
Options	47,043	94	105	15,478	90	102
	<b>614,961</b>	<b>8,918</b>	<b>10,214</b>	<b>502,505</b>	<b>8,204</b>	<b>10,176</b>
<b>Foreign exchange contracts</b>						
Swaps / Forwards	162,525	1,217	457	142,477	916	471
Cross currency interest rate swaps	59,440	1,029	677	56,638	1,056	602
Options	74,236	571	569	32,877	158	163
	<b>296,201</b>	<b>2,817</b>	<b>1,703</b>	<b>231,992</b>	<b>2,130</b>	<b>1,236</b>
<b>Equity contracts</b>						
Swaps	5,359	117	92	3,710	14	85
Options	3,231	163	23	1,409	43	-
	<b>8,590</b>	<b>280</b>	<b>115</b>	<b>5,119</b>	<b>57</b>	<b>85</b>
<b>Commodity contracts</b>						
Swaps / Options	3,383	152	144	5,702	544	530
<b>Total trading derivatives (Notes: 16, 26)</b>	<b>923,135</b>	<b>12,167</b>	<b>12,176</b>	<b>745,318</b>	<b>10,935</b>	<b>12,027</b>

### Positions of ALM – economic hedges

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Interest rate related contracts</b>						
Swaps	77,126	74	34	54,518	107	104
<b>Foreign exchange contracts</b>						
Cross currency interest rate swaps	6,430	376	58	8,403	362	51
<b>Total derivatives used as economic hedges (Notes: 16, 26)</b>	<b>83,556</b>	<b>450</b>	<b>92</b>	<b>62,921</b>	<b>469</b>	<b>155</b>

## Hedging derivatives

The Group's ALM function utilises derivative interest rate contracts in the management of the Group's interest rate risk arising from non-trading or ALM activities, which are contained in the Group's Banking Book. Interest rate risk arises when interest-sensitive assets have different maturities or repricing characteristics than the corresponding interest-sensitive liabilities. The Group's objective for managing interest rate risk in the Banking Book is to reduce the structural interest rate risk within each currency and, thus, the volatility of net interest margins. Derivative strategies used to achieve this objective involve either swapping currency interest rate exposures or modifying repricing characteristics of certain interest-sensitive assets or liabilities so that the changes in interest rates do not have a significant adverse effect on the net interest margins and cash flows of the Banking Book. Group policies to achieve these strategies currently require the use of both cash flow hedges and fair value hedges.

### Cash flow hedging derivatives

Most of the hedging derivatives are CZK single currency interest rate swaps. The Group uses these instruments to hedge floating interest income from expected reverse repo operations with the Czech National Bank earning the 14-day interest repo rate. The hedging swap contracts are arranged to swap the floating interest rate 3M PRIBOR or 6M PRIBOR paid by the Group and the fixed interest rate the Group receives. The hedging construction is effective due to the strong correlation between the 14-day interest repo rate and 3M or 6M PRIBOR.

The Group also uses single currency interest rate swaps

- to hedge the interest rate risk arising from changes in external interest rates on a group of client term deposits with contractual maturity varying from one week to six months and on a group of non-standard client current accounts (the variability in the interest paid on the client floating rate deposits is effectively hedged by the fixed rate payer/floating rate receiver swaps).
- to hedge the interest rate risk arising from changes in external interest rates on a group of non-retail client current accounts (the variability in the interest paid on the client deposits is effectively hedged by the fixed rate payer/floating rate receiver swaps).
- to convert floating-rate client loans to fixed rates.

Cross currency interest rate swaps are used to hedge currency risk resulting from interest income accrued on foreign currency investment debt securities. These fixed and floating interest earning securities are included in Available-for-sale financial assets and in Held-to-maturity investments of the Group's statement of financial position.

The contract or notional amounts and positive and negative fair values of the Group's outstanding cash flow hedging derivatives as at 31 December 2016 and 2015 are set out as follows:

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Cash flow hedges</b>						
Single currency interest rate swaps	106,722	5,150	2,476	107,058	6,245	2,915
Cross currency interest rate swaps	11,922	422	866	14,416	533	867
<b>Total hedging derivatives</b>	<b>118,644</b>	<b>5,572</b>	<b>3,342</b>	<b>121,474</b>	<b>6,778</b>	<b>3,782</b>

Net gains and losses on cash flow hedges reclassified to the statement of income are as follows:

(CZKm)	2016	2015
Interest income (Note: 31)	930	824
Net gains from financial instruments at fair value through profit or loss (Note: 31)	12	4
Taxation (Note: 13)	(120)	(152)
<b>Net gains</b>	<b>822</b>	<b>676</b>

In 2016, a gain of CZK 3 m was recognised in the statement of income due to hedge ineffectiveness from cash flow hedges (2015: a gain of CZK 42 m).

In 2016, the discontinuation of hedge accounting (due to sales of / impairment on underlying hedged bonds or retrospective hedge effectiveness test failure) resulted in a reclassification of the associated cumulative gains of CZK 10 m from equity to the statement of income (2015: losses of CZK 38 m). The gains / losses are included in Net gains from financial instruments at fair value through profit or loss.

Since the cash flows from the hedging interest rate swaps are variable and difficult to predict, the Group uses the remaining contractual maturity analysis of the hedging derivatives notional amounts instead of the expected future cash flows from the hedged items. As the objective of the hedging structure is to achieve fixed interest income, the information of the hedging swaps notional amounts remaining maturity is more relevant. Cash flows from hedged items are expected to occur in the same periods as the remaining maturity of cash flows from hedging derivatives.

The following table shows the notional amounts of hedging derivatives by remaining contractual maturity at 31 December 2016 and 2015:

(CZKm)	2016	2015
Less than 3 months	5,810	6,953
More than 3 months but not more than 6 months	9,492	2,395
More than 6 months but not more than 1 year	7,820	5,273
More than 1 year but not more than 2 years	20,978	23,112
More than 2 years but not more than 5 years	58,348	52,050
More than 5 years	16,196	31,691
	<b>118,644</b>	<b>121,474</b>

#### Fair value hedging derivatives

Cross currency interest rate swaps are used to hedge both FX risks and interest rate risks arising from the movement in the fair value of foreign currency fixed rate bonds classified as Available-for-sale attributable to the changes in the FX rate and the risk-free (interest rate swap) yield curve. A fixed rate payer (foreign currency)/floating rate receiver (home currency) interest rate swap is expected to be a highly effective hedge.

Interest rate swaps are used by the Group to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Available-for-sale attributable to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be a highly effective hedge.

Fair value hedges for portfolios of retail non-maturity deposits have been used to hedge interest rate risk arising from changes in fair value of non-maturity retail deposits to changes in the risk-free yield curve. The portfolio consisting of the part of retail current and savings accounts was designated as a hedged item. The interest rate risk is effectively hedged by the single currency fixed rate receiver/floating rate payer swaps.

Fair value hedges for portfolios of fixed rate loans have been used to hedge interest rate risk arising from changes in the fair value of fixed rate loans to changes in the risk-free yield curve. The interest rate risk is effectively hedged by the single currency fixed rate payer/floating rate receiver swaps.



Interest rate swaps are used by the Group to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Loans and receivables, i.e. private issues without active secondary market, to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be a highly effective hedge.

The contract or notional amounts and positive and negative fair values of the Group's outstanding fair value hedging derivatives as at 31 December 2016 and 2015 are set out as follows:

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Fair value hedges</b>						
<i>Single currency interest rate swaps</i>						
Fair value micro hedges	51,012	36	5,118	35,786	17	4,855
Fair value portfolio hedges	304,122	6,048	2,001	264,713	5,105	1,988
<i>Cross currency interest rate swaps</i>						
Fair value micro hedges	516	-	71	923	-	149
<b>Total hedging derivatives</b>	<b>355,650</b>	<b>6,084</b>	<b>7,190</b>	<b>301,422</b>	<b>5,122</b>	<b>6,992</b>

In 2016, the net losses in the amount of CZK 724 m (2015: CZK 318 m) realised on the hedged item attributable to the hedged interest rate risk is included in Net gains from financial instruments at fair value through profit or loss.

Net gains realised on the hedging contracts, which are included in Net gains from financial instruments at fair value through profit or loss, amounted to CZK 679 m (2015: CZK 216 m).

## 21. INVESTMENT PROPERTY

(CZKm)	2016	2015
Cost at 1 January	-	904
Depreciation and impairment at 1 January	-	(620)
<b>Net book value at 1 January</b>	<b>-</b>	<b>284</b>
Disposals	-	(2)
Transfers to assets held for sale (Note: 24)	-	(278)
Depreciation	-	(4)
<b>Net book value at 31 December</b>	<b>-</b>	<b>-</b>
of which		
Cost	-	-
Depreciation and impairment	-	-
<b>Fair value at 31 December</b>	<b>-</b>	<b>-</b>
<b>Other disclosures</b>		
Rental income	-	7
Direct operating expenses from investments generating rental income	-	12
Direct operating expenses from investments not generating rental income	-	2

In 2015, the Group decided to sell the investment property held by Merrion Properties and thus to terminate its real estate activities. Based on that decision, the assets were transferred from the caption of Investment property to Non-current assets held-for-sale. The value of the assets was based on a valuation performed by an independent expert. The assets were sold in September 2016 (Note: 24).



**22. PROPERTY AND EQUIPMENT**

(CZKm)	Land and buildings	IT equipment	Office equipment	Other	Construction in progress	Total
Cost at 1 January 2015	7,791	252	573	4,397	111	13,124
Depreciation and impairment at 1 January 2015	(3,206)	(232)	(445)	(2,445)	-	(6,328)
<b>Net book value at 1 January 2015</b>	<b>4,585</b>	<b>20</b>	<b>128</b>	<b>1,952</b>	<b>111</b>	<b>6,796</b>
Transfers	82	24	11	1,590	(1,707)	-
Additions	-	-	-	-	1,807	1,807
Additions through business combinations	-	417	2	26	71	516
Disposals	(42)	-	(1)	(542)	-	(585)
Transfers to assets held for sale (Note: 24)	(62)	-	-	(20)	-	(82)
Depreciation	(282)	(14)	(31)	(192)	-	(519)
Depreciation related to operating leased assets (Note: 33)	-	-	-	(270)	-	(270)
Impairment charge (Note: 12)	-	-	-	(1)	-	(1)
<b>Net book value at 31 December 2015</b>	<b>4,281</b>	<b>447</b>	<b>109</b>	<b>2,543</b>	<b>282</b>	<b>7,662</b>
of which						
Cost	7,601	674	589	4,951	282	14,097
Depreciation and impairment	(3,320)	(227)	(480)	(2,408)	-	(6,435)

(CZKm)	Land and buildings	IT equipment	Office equipment	Other	Construction in progress	Total
Cost at 1 January 2016	7,601	674	589	4,951	282	14,097
Depreciation and impairment at 1 January 2016	(3,320)	(227)	(480)	(2,408)	-	(6,435)
<b>Net book value at 1 January 2016</b>	<b>4,281</b>	<b>447</b>	<b>109</b>	<b>2,543</b>	<b>282</b>	<b>7,662</b>
Transfers	242	365	21	4,132	(4,760)	-
Additions	-	-	-	-	4,948	4,948
Disposals	(27)	(1)	(3)	(1,503)	-	(1,534)
Depreciation	(274)	(193)	(31)	(200)	-	(698)
Depreciation related to operating leased assets (Note: 33)	-	-	-	(356)	-	(356)
Impairment charge (Note: 12)	(9)	-	-	(4)	-	(13)
<b>Net book value at 31 December 2016</b>	<b>4,213</b>	<b>618</b>	<b>96</b>	<b>4,612</b>	<b>470</b>	<b>10,009</b>
of which						
Cost	7,729	1,030	586	7,175	470	16,990
Depreciation and impairment	(3,516)	(412)	(490)	(2,563)	-	(6,981)

In 2015, the following transactions were made by the Group which resulted in additions of property and equipment through business combinations:

1. Acquisition of entities Patria Online, Patria Finance and Patria CF by the Group in 2015 (Note: 3);
2. Acquisition of assets related to the ICT function as a result of the reintegration of ICT services back to ČSOB (Note: 3).

ČSOB Leasing owns assets leased out under operating leases, which represent 88% (2015: 78%) of the net book value of the Other class of property and equipment.

Property and equipment are assessed as non-current assets.

### 23. GOODWILL AND OTHER INTANGIBLE ASSETS

	Goodwill	Software	Other intangible assets	Construction in progress	Total
<b>(CZKm)</b>					
Cost at 1 January 2015	3,636	3,385	835	52	7,908
Amortisation and impairment at 1 January 2015	(1,029)	(3,157)	(809)	-	(4,995)
<b>Net book value at 1 January 2015</b>	<b>2,607</b>	<b>228</b>	<b>26</b>	<b>52</b>	<b>2,913</b>
Transfers	-	195	44	(239)	-
Additions	-	-	-	268	268
Acquisition of business under common control (Note: 3)	-	1,776	-	541	2,317
Disposals	-	(9)	(2)	-	(11)
Amortisation	-	(87)	(11)	-	(98)
Impairment (Note: 12)	(66)	-	-	-	(66)
<b>Net book value at 31 December 2015</b>	<b>2,541</b>	<b>2,103</b>	<b>57</b>	<b>622</b>	<b>5,323</b>
of which					
Cost	3,636	5,387	876	622	10,521
Amortisation and impairment	(1,095)	(3,284)	(819)	-	(5,198)
<b>(CZKm)</b>					
Cost at 1 January 2016	3,636	5,387	876	622	10,521
Amortisation and impairment at 1 January 2016	(1,095)	(3,284)	(819)	-	(5,198)
<b>Net book value at 1 January 2016</b>	<b>2,541</b>	<b>2,103</b>	<b>57</b>	<b>622</b>	<b>5,323</b>
Transfers	-	289	73	(362)	-
Additions	-	-	-	1,045	1,045
Disposals	-	(54)	(36)	-	(90)
Amortisation	-	(553)	(17)	-	(570)
Impairment (Note: 12)	-	(14)	-	(60)	(74)
<b>Net book value at 31 December 2016</b>	<b>2,541</b>	<b>1,771</b>	<b>77</b>	<b>1,245</b>	<b>5,634</b>
of which					
Cost	3,636	5,839	654	1,305	11,434
Amortisation and impairment	(1,095)	(4,068)	(577)	(60)	(5,800)

In 2015, assets related to the ICT function were acquired by the Group as a result of the reintegration of ICT services back to ČSOB (Note: 3). They are reported under Acquisition of business under common control.

Included in Construction in progress is internally developed software in the net amount of CZK 1,116 m as at 31 December 2016 (31 December 2015: CZK 546 m).

Goodwill and other intangible assets are assessed as non-current assets.

Goodwill does not generate cash flows independently of other groups of assets and thus is assigned to cash generating units (CGUs) for the purposes of impairment testing. These CGUs are based upon how management monitors the business and represents the lowest level to which goodwill can be allocated on a reasonable basis. An allocation to CGUs of the Group's goodwill attributable to shareholders is shown below:

(CZK m)	2016	2015
Retail segment and SME clients – Bank	2,511	2,511
Retail segment and SME clients – subsidiaries	30	30
	2,541	2,541

#### **Retail segment and SME clients - Bank**

The recoverable amount for the Retail segment and SME clients - Bank was determined based on the value-in-use methodology. The calculation uses cash flow projections from business plans for the forthcoming four years which are then extrapolated for a five further years using the expected average growth rate of 3%; after that a terminal value is applied.

Cash flows in the Retail segment and SME clients - Bank are based on the net profit generated by the cash-generating unit above the required capital and a terminal value of the business. For the calculation of the terminal value a sustainable discount rate of 10.1% (2015: 9.8%) and no long term growth rates were used in 2016 and 2015.

The value in use is particularly sensitive to a number of key assumptions:

- The growth rate in forecasted cash flows beyond the terminal year of the budget. The Group has a conservative approach when calculating the terminal value, which implies that no growth rate for Retail segment and SME clients - Bank has been used for extrapolation purposes beyond the budget period.
- The risk discount rate. For Retail segment and SME clients - Bank an average risk discount rate of 10.0% has been applied (2015: 9.8%). This reflects a risk-free rate in the Eurozone, long-term inflation in the Czech market and in the Eurozone, the credit default swap spread for the Czech Republic relative to the Eurozone, an average 'beta' factor for relative market risk, including the market risk premium.

The key assumptions described above may change as economic and market conditions change.

The outcome of the impairment assessment was that it is considered unlikely that goodwill in respect of the Retail segment and SME clients - Bank would be impaired given that the value-in-use is significantly higher than the carrying value of goodwill.

The management believes that reasonable potential changes in the key assumptions on which the recoverable amount is based would not cause it to fall below the carrying amount.

## 24. NON-CURRENT ASSETS HELD-FOR-SALE

(CZKm)	Investment property	Land and buildings	Other (Note: 18)	Total
<b>Net book value at 1 January 2015</b>	-	<b>491</b>	<b>24</b>	<b>515</b>
Transfer from Property and equipment (Note: 22)	-	62	20	82
Transfer from investment property (Note: 21)	278	-	-	278
Additions	-	38	54	92
Disposals	-	(536)	(59)	(595)
Impairment charge (Note: 12)	-	(9)	-	(9)
<b>Net book value at 31 December 2015</b>	<b>278</b>	<b>46</b>	<b>39</b>	<b>363</b>
of which				
Cost	278	55	39	372
Impairment	-	(9)	-	(9)
(CZKm)	Investment property	Land and buildings	Other (Note: 18)	Total
<b>Net book value at 1 January 2016</b>	<b>278</b>	<b>46</b>	<b>39</b>	<b>363</b>
Additions	-	1	71	72
Disposals	(278)	(32)	(73)	(383)
<b>Net book value at 31 December 2016</b>	<b>-</b>	<b>15</b>	<b>37</b>	<b>52</b>
of which				
Cost	-	24	37	61
Impairment	-	(9)	-	(9)

In 2015, the Group decided to sell its investment property in the Czech Republic. The movement in 2015 represents the transfer of the investment property in Merrion Properties from the caption of Investment property to Non-current assets held for sale. The Group sold the assets in September 2016 and received a consideration of CZK 311 m. As a result of the sale, the Group recognised a realised gain of CZK 38 m from the derecognition of held-for-sale assets reported as part of Other income in 2016.

Movements disclosed in Transfer from Property and equipment represent buildings and other property which the Group decided to sell. The buildings are measured at the lower of their carrying amount and fair value less costs to sell. The fair value of the buildings was calculated based on indicative market prices.

The impairment losses resulting from the decreased recoverable amount of the buildings were caused by a decrease of expected future cash-flows less costs to sell.

## 25. OTHER ASSETS

(CZKm)	2016	2015
Other debtors, net of provisions (Notes: 32, 34, 37, 40.2)	798	790
Accrued income (Notes: 32, 34, 37, 40.2)	332	382
Prepaid charges	355	317
VAT and other tax receivables	132	143
Receivables from securities clearing (Notes: 32, 34, 37, 40.2)	61	28
Other receivables from clients (Notes: 32, 34, 37, 40.2)	8	24
Other	555	580
	<b>2,241</b>	<b>2,264</b>

Other assets are assessed as current assets.

## 26. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

(CZKm)	2016	2015
<b>Financial liabilities held for trading</b>		
Short positions	13,025	6,147
Derivative contracts (Note: 20)		
Trading derivatives	12,176	12,027
Derivatives used as economic hedges	92	155
Term deposits	3,184	1,580
Repo transactions	155	-
Bonds and investment certificates issued	11,412	10,061
	<b>40,044</b>	<b>29,970</b>
<b>Financial liabilities designated at fair value through profit or loss</b>		
Investment certificates	1,620	-
	<b>1,620</b>	-
<b>Financial liabilities at fair value through profit or loss</b>	<b>41,664</b>	<b>29,970</b>

The amount that the Group would contractually be required to pay at the maturity of the financial liabilities designated at fair value through profit or loss is by CZK 73 m lower than the carrying amount at 31 December 2016 (31 December 2015: CZK Nil).

The changes in the fair value of the Financial liabilities designated at fair value through profit or loss attributable to changes in own credit risk were not significant.

Included in Financial liabilities designated at fair value through profit or loss are debt instruments containing an embedded derivative.

## 27. FINANCIAL LIABILITIES AT AMORTISED COST

(CZKm)	2016	2015
<b>Deposits received from credit institutions</b>		
Current accounts and overnight deposits	9,168	10,853
Term deposits	13,978	12,933
Repo transactions	9,452	-
	<b>32,598</b>	<b>23,786</b>
<b>Deposits received from other than credit institutions</b>		
Current accounts and overnight deposits	441,896	389,212
Term deposits	8,299	10,762
Savings deposits	214,689	213,355
Pension funds clients deposits	29	24
Other deposits	11,249	8,574
	<b>676,162</b>	<b>621,927</b>
<b>Debt securities in issue</b>		
Bonds issued	20,970	20,632
Promissory notes	202,027	145,860
	<b>222,997</b>	<b>166,492</b>
<b>Financial liabilities at amortised cost</b>	<b>931,757</b>	<b>812,205</b>

## 28. OTHER LIABILITIES

(CZKm)	2016	2015
Payables to employees including social security charges (Notes: 32, 34, 37, 40.3)	2,025	1,840
Accrued charges (Notes: 32, 34, 37, 40.3)	1,910	2,572
Other creditors (Notes: 32, 34, 37, 40.3)	568	938
Income received in advance	157	167
Other debts to clients (Notes: 32, 34, 37, 40.3)	122	44
VAT and other tax payables	104	93
Payables to securities clearing entities (Notes: 32, 34, 37, 40.3)	4	2
Other (Notes: 32, 34, 37, 40.3)	55	71
	<b>4,945</b>	<b>5,727</b>

As at 31 December 2015, the balance of Accrued charges included unsettled consideration in respect of the acquisition of ICT function in the amount of CZK 955 m (Note: 3).

Other liabilities are assessed as current liabilities.

## 29. PROVISIONS

(CZKm)	Pending legal issues and other losses	Restructuring	Contractual engagements	Loans commitments and Guarantees (Note: 35)	Total
<b>At 1 January 2015</b>	<b>368</b>	<b>37</b>	<b>58</b>	<b>273</b>	<b>736</b>
Acquisition of business under common control	10	-	-	-	10
Additions	28	100	-	95	223
Amounts utilised	(295)	(37)	(16)	-	(348)
Unused amounts reversed	(6)	-	-	(80)	(86)
Discount amortisation (Note: 6)	-	-	3	-	3
Foreign currency translation	-	-	-	(2)	(2)
<b>At 31 December 2015</b>	<b>105</b>	<b>100</b>	<b>45</b>	<b>286</b>	<b>536</b>
Additions	334	-	27	141	502
Amounts utilised	(62)	(51)	(35)	-	(148)
Unused amounts reversed	(17)	-	(8)	(195)	(220)
Discount amortisation (Note: 6)	-	-	3	-	3
<b>At 31 December 2016</b>	<b>360</b>	<b>49</b>	<b>32</b>	<b>232</b>	<b>673</b>

### Restructuring

During 2012, the Group started a restructuring programme to reduce the total number of personnel, resulting in the creation of a provision of CZK 191 m. The Group used the remaining provision of CZK 37 m to cover the costs related to further reductions of the number of personnel in 2015.

During 2015, the Group started a new restructuring programme, resulting in the creation of a provision of CZK 100 m (Note: 10). In the framework of this restructuring programme the total number of personnel should be reduced in 2017.

### *Pending legal issues and other losses*

Provisions for legal issues and other losses represent an obligation to cover potential risks resulting from litigation, where the Group is the defendant.

The Group is involved in a number of ongoing legal disputes, the resolution of which may have an adverse financial impact on the Group. Based upon historical experience and expert reports, the Group assesses the developments in these cases, and the likelihood and the amount of potential financial losses which are appropriately provided for.

The Group's policy is to create a provision, where the possibility of an outflow of resources embodying economic benefits to settle the obligation is more than 50%. In such cases the Group creates a provision in the full amount to cover the possible cost in the event of loss.

In 2016, the Group had a provision for pending legal issues and other losses in the total amount of CZK 360 m. It is expected that the majority of the costs will be incurred in the next 3 years.

On a quarterly basis, the Group monitors the status of all cases and makes a decision whether to create, utilise or reverse any provision.

The Group does not disclose the details underlying the disputes as the disclosure may have an impact on the outcome of the disputes and may seriously harm the Group's interests.

### *Contractual engagements*

A number of leasehold property arrangements for which, on a net basis, the unavoidable contractual rental costs exceeds normal market rental conditions exists in the Group. This provision represents the present value of the future net rental losses that will arise. It is expected that a majority of the costs will be incurred over the next 3 years.

## 30. SHARE CAPITAL AND OTHER RESERVES

As at 31 December 2016, the total authorised share capital was CZK 5,855 m (31 December 2015: CZK 5,855 m) and comprised of 292,750,002 ordinary shares with a nominal value of CZK 20 each (31 December 2015: 292,750,002 ordinary shares with a nominal value of CZK 20 each) and is fully paid up.

Based on the resolution of the sole shareholder dated 16 December 2015, ČSOB issued one ordinary share with a nominal value of CZK 20 and with a share premium of CZK 5,419,999,980 (evidenced by an entry in the Register of Companies dated 21 December 2015).

No Treasury shares were held by the Group at 31 December 2016 and 2015.

On 31 December 2016, the Bank was directly controlled by KBC Bank whose ownership interest in ČSOB was 100% (31 December 2015: 100%). On the same date, KBC Bank was controlled by the KBC Group and, therefore, KBC Group was the company indirectly exercising ultimate control over the Bank.

### **Other reserves**

The movement of Other reserves in 2016 and 2015 are as follows:

(CZKm)	Available- for-sale reserve	Cash flow hedge reserve	Total
<b>At 1 January 2015</b>	<b>3,732</b>	<b>3,192</b>	<b>6,924</b>
Other comprehensive income (Note: 31)	212	(583)	(371)
<b>At 31 December 2015</b>	<b>3,944</b>	<b>2,609</b>	<b>6,553</b>
Other comprehensive income (Note: 31)	(1,716)	(636)	(2,352)
<b>At 31 December 2016</b>	<b>2,228</b>	<b>1,973</b>	<b>4,201</b>

### 31. COMPONENTS OF OTHER COMPREHENSIVE INCOME

(CZKm)	2016	2015
<b>Cash flow hedges</b>		
Net unrealised gains on cash flow hedges	157	108
Net gains on cash flow hedges reclassified to the statement of income (Note: 20)	(942)	(828)
Tax effect relating to cash flow hedges (Note: 13)	<u>149</u>	<u>137</u>
	(636)	(583)
<b>Available-for-sale financial assets</b>		
Net unrealised (losses) / gains on available-for-sale financial investments	(589)	868
Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal	(1,294)	(326)
Net realised gains on available-for-sale financial investments amortised to the statement of income on reclassified assets (Note: 17)	(197)	(259)
Tax effect relating to available-for-sale financial investments (Note: 13)	<u>396</u>	<u>(54)</u>
	(1,684)	229
<b>Share of other comprehensive income of associates</b>	<u>(32)</u>	<u>(17)</u>
<b>Other comprehensive income for the year, net of tax attributable to owners of the parent</b>	<b>(2,352)</b>	<b>(371)</b>
Non-controlling interests	1	(9)
<b>Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods</b>	<b>(2,351)</b>	<b>(380)</b>

In 2016, net gain of CZK 1,295 m resulting from the transaction of merger Visa Inc. and Visa Europe Ltd. is reported as part of Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal.



## 32. FAIR VALUE OF FINANCIAL INSTRUMENTS

### Financial assets and liabilities at fair value

The Group's accounting policy on fair value measurements is discussed in the Accounting policies (Note 2.4 (3)).

Financial assets and liabilities at fair value (available-for-sale, held for trading, designated at fair value through profit or loss) are valued as follows:

- Level 1

If available, published price quotations in active markets are used to determine the fair value of financial assets or financial liabilities. Revaluation is obtained using prices of an identical asset or liability, which means that no model is involved in the process of a revaluation. Financial instruments valued on this basis include spot foreign exchange contracts and listed shares and bonds.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using valuation techniques.

- Level 2

Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observed from the market.

Financial instruments valued on this basis include forward interest rate, foreign exchange and commodity contracts, mortgage bonds, money market loans and deposits.

- Level 3

Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Financial instruments for which the parameters are not observable include unlisted shares, a part of the portfolio of trading derivatives, a part of the portfolio of mortgage bonds and selected listed but not traded bonds.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to determine a fair value that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models for determining the fair value of common and less complex financial instruments like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter derivatives like interest rate swaps. The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Group uses proprietary valuation models, which are usually developed from recognised valuation models. Some or all of the significant inputs into these models

may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Examples of instruments involving significant unobservable inputs include certain over-the-counter structured derivatives, certain loans and securities for which there is no active market. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, the determination of expected future cash flows on the financial instrument being valued, the determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The Valuation policy is subject to approval of the ČSOB Risk and Capital Oversight Committee and KBC Group Valuation Committee. The process for the approval of any new product consist also of an assessment of the valuation of the product and the eventual new valuation model for the product has to be approved before the product is endorsed or approval of the model is a blocking condition for the product implementation. The New and Active Product Process also requires a regular review of all products and the assessment of valuation quality is an important part of the review. Any valuation model, which uses not directly observable inputs, is subject to the Parameter review policy. The policy requires quarterly assessment of all parameters correctness. The Group currently checks the valuation of all bonds quarterly.

The Group also monitors the quality of bonds valuations on a daily basis. If an asset quote quality does not meet the required criteria for Level 1 or Level 2 the asset is transferred to Level 3 and vice versa. The monitoring process evaluates among others the frequency of quote updates.

The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

(CZK <sup>m</sup> )	Level 1	Level 2	Level 3	Total
<b>Financial assets recorded at fair value</b>				
Financial assets held for trading				
Loans and advances	-	170	-	170
Debt instruments	3,075	762	3,382	7,220
Equity securities	1	-	-	1
Derivative contracts	-	12,517	100	12,617
Financial assets designated at fair value through profit or loss				
Debt instruments	-	-	-	-
Available-for-sale financial assets				
Debt securities	38,835	13,261	4,427	56,522
Equity securities	-	-	416	416
Fair value adjustments of the hedged items in portfolio hedge				
Derivatives used for hedging	-	852	-	852
<b>Financial liabilities recorded at fair value</b>				
Financial liabilities held for trading				
Short positions	13,025	-	-	13,025
Derivative contracts	-	12,126	142	12,268
Term deposits	-	3,184	-	3,184
Repo transactions	-	155	-	155
Bonds issued	-	11,412	-	11,412
Financial liabilities designated at fair value through profit or loss				
Debt instruments	-	1,620	-	1,620
Fair value adjustments of the hedged items in portfolio hedge				
Derivatives used for hedging	-	4,796	-	4,796
Derivatives used for hedging				
	-	10,532	-	10,532

The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2015:

(CZK m)	Level 1	Level 2	Level 3	Total
<b>Financial assets recorded at fair value</b>				
Financial assets held for trading				
Loans and advances	-	-	-	-
Debt instruments	6,748	5,622	5,714	18,084
Equity securities	6	-	-	6
Derivative contracts	-	11,315	89	11,404
Financial assets designated at fair value through profit or loss				
Debt instruments	-	-	15	15
Available-for-sale financial assets				
Debt securities	38,051	16,192	4,388	58,631
Equity securities	-	-	1,330	1,330
Fair value adjustments of the hedged items in portfolio hedge	-	957	-	957
Derivatives used for hedging	-	11,900	-	11,900
<b>Financial liabilities recorded at fair value</b>				
Financial liabilities held for trading				
Short positions	6,147	-	-	6,147
Derivative contracts	-	12,020	162	12,182
Term deposits	-	1,580	-	1,580
Bonds issued	-	10,061	-	10,061
Fair value adjustments of the hedged items in portfolio hedge	-	4,062	-	4,062
Derivatives used for hedging	-	10,774	-	10,774

Yield curve used in the mortgage bonds valuation model for discounting future cash flows is constructed from IRS rates and respective credit spreads. The credit spreads are derived from available market quotes of mortgage bonds, government bonds and IRS rates.

The spreads for the first five years of maturity were exclusively derived from market observable quotes of mortgage bonds until the end of 2015. Therefore mortgage bonds with a maturity of up to five years were included in level 2. The spread for the rest of the curve was derived from observed mortgage bond spread at 5 and 10 years and the slope of the Czech government yield curve. The management considered this a significant market unobservable input and, as a consequence, the mortgage bonds with a maturity of longer than 5 years were reported as part of Level 3 in 2015.

In 2016, changes were observed on the mortgage bond market. As a consequence of these changes, only the spreads for maturities up to one year were exclusively derived from the market observable quotes of mortgage bonds. Therefore only mortgage bonds with a maturity up to one year are included in Level 2. The spread for the rest of the curve are derived from observed mortgage bond spread at one year and slope of the Czech government yield curve. The management considers this a significant market unobservable input, and as a consequence, the mortgage bonds with a maturity of longer than one year were transferred to Level 3 in 2016.

The spread according to bond maturity was 75 bps (7-year) to 142 bps (above 25-year) in 2015 and 96 bps (7-year) to 182 bps (above 30-year) in 2016.

In 2015, a model for the valuation of bonds issued by Česká Exportní Banka (ČEB) changed. Yield curves (different for floating and fix bonds) used in the ČEB bonds valuation model for discounting future cash flows are constructed from IRS rates and respective credit spreads. The credit spreads are

derived from the quotes of the most liquid bonds issued by ČEB and IRS rates. The management considers this a significant market unobservable input and, as a consequence, the bonds issued by ČEB remained classified as Level 3.

The implementation of the new ČEB valuation model, which has been used since June 2015, resulted in unrealised gains of CZK 245 m recorded in Net gains from financial instruments at fair value through profit or loss and unrealised gains of CZK 75 m recorded in Available-for-sale reserve in 2015. There were no changes of the ČEB valuation model in 2016. The spreads are regularly updated, at the latest quarterly. The spread according to bond maturity was 16 bps (1-year) to 195 bps (10-year) for fixed bonds and 12 bps (1-year) to 53 bps (10-year) for floating bonds after last review in December 2016 (31 December 2015: 19 bps (1-year) to 159 bps (10-year) for fixed bonds and 28 bps (1-year) to 47 bps (10-year) for floating bonds).

Following the declared intention of VISA Inc. to acquire VISA Europe, the Group changed a model for the valuation of its share in VISA Europe in 2015. The model reflected the expected set up of the transaction. The model calculated the fair value of the Group's share in VISA Europe combining an upfront cash consideration, an upfront share consideration and an earn-out, which would be payable in cash four years past the merger. The value of the share was derived from the report of VISA Europe. The implementation of this model resulted in unrealised gains of CZK 861 m recorded in Available-for-sale reserve in 2015.

In June 2016, the merger took place and the original Group's share in VISA Europe and the respective unrealised gain of CZK 1,153 m retained in equity were derecognised. The new share in VISA Inc. classified as Available-for-sale financial asset in the amount of CZK 251 m is subject to fair value measurement based on the quoted price of VISA Inc.

All transfers of financial instruments among the levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

### Movements in Level 3 financial instruments measured at fair value

The following table shows the reconciliation of the opening and closing amount of financial assets which are recorded at fair value using valuation techniques based on non-market observable inputs:

(CZK <sub>m</sub> )	Financial assets held for trading		Financial assets designated at fair value through profit or loss	Available-for-sale financial assets		Total
	Debt securities	Financial derivatives	Debt securities	Debt securities	Equity securities	
<b>At 1 January 2015</b>	<b>5,151</b>	-	-	<b>3,158</b>	<b>444</b>	<b>8,753</b>
Total gains / (losses) recorded in profit or loss	370	89	15	(80)	-	394
Total gains recorded in other comprehensive income	-	-	-	16	861	877
Transfers into level 3	155	-	-	-	-	155
Purchases	2,110	-	-	1,294	-	3,404
Settlement	(512)	-	-	-	-	(512)
Sales	(1,560)	-	-	-	-	(1,560)
Acquisition of entity under common control	-	-	-	-	25	25
<b>At 31 December 2015</b>	<b>5,714</b>	<b>89</b>	<b>15</b>	<b>4,388</b>	<b>1,330</b>	<b>11,536</b>
Total gains recorded in profit or loss related to assets held at the end of the reporting period	359	89	15	-	-	<b>463</b>
(CZK <sub>m</sub> )	Financial assets held for trading		Financial assets designated at fair value through profit or loss	Available-for-sale financial assets		Total
	Debt securities	Financial derivatives	Debt securities	Debt securities	Equity securities	
<b>At 1 January 2016</b>	<b>5,714</b>	<b>89</b>	<b>15</b>	<b>4,388</b>	<b>1,330</b>	<b>11,536</b>
Total gains / (losses) recorded in profit or loss	60	199	5	-	10	274
Total gains recorded in other comprehensive income	-	-	-	73	17	90
Transfers into level 3	40	-	-	-	-	40
Transfers out of level 3	(814)	-	-	-	-	(814)
Purchases	2,362	-	-	-	354	2,716
Settlement	(991)	(188)	-	-	-	(1,179)
Sales	(2,989)	-	(20)	(34)	(1,295)	(4,338)
<b>At 31 December 2016</b>	<b>3,382</b>	<b>100</b>	-	<b>4,427</b>	<b>416</b>	<b>8,325</b>
Total gains recorded in profit or loss related to assets held at the end of the reporting period	47	199	-	-	-	<b>246</b>

Total gains recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss, Net realised gains on available-for-sale financial assets and Impairment losses of the statement of income.

The following table shows the reconciliation of the opening and closing amount of financial liabilities which are recorded at fair value using valuation techniques based on non-market observable inputs:

(CZKm)	Financial liabilities held for trading	Financial derivatives
<b>At 1 January 2015</b>		-
Total losses recorded in profit or loss	162	
<b>At 31 December 2015</b>		<b>162</b>
Total losses recorded in profit or loss related to liabilities held at the end of the reporting period	162	
<b>At 1 January 2016</b>		<b>162</b>
Total losses recorded in profit or loss	178	
Settlement	(198)	
<b>At 31 December 2016</b>		<b>142</b>
Total losses recorded in profit or loss related to liabilities held at the end of the reporting period	178	

Total losses recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss of the statement of income.

### Impact on fair value of Level 3 financial instruments measured at fair value of changes to key assumptions

Management considers the value of the credit spread included in the discount factor applied on estimated future cash flows from the mortgage bonds in periods after the fifth year (applicable in 2015) and in periods after the first year (applicable in 2016) from the balance sheet date as a key assumption not derived from observable market inputs which is influencing the fair value of Level 3 financial instruments.

As at 31 December 2016, an increase / (decrease) of the credit spread by 50 basis points would (decrease) / increase the fair value of the mortgage bonds and bonds issued by ČEB included in Level 3 by CZK 49 m and CZK 84 m, respectively (2015: CZK 54 m and CZK 91 m, respectively). Such a change in the credit spread is based on the variability of mortgage bond and ČEB bond quotes that were observed by the management on the market.

Management believes that reasonably possible changes in other non-observable market inputs in the valuation models used would not have a material impact on the estimated fair values.

### Transfers between Level 1 and 2 of the fair value hierarchy for financial instruments

The following table shows transfers between a group of financial instruments with a market quoted price and those for which the fair value is calculated using valuation techniques based on market observable inputs:

(CZKm)	Transfers from Level 1 to Level 2		Transfers from Level 2 to Level 1	
	2016	2015	2016	2015
<b>Financial assets</b>				
Financial assets held for trading				
Debt instruments	-	3	-	-

### Financial assets and liabilities not carried at fair value

Set out below is a comparison of the carrying amounts and fair values of the Group's financial instruments that are not carried at fair value in the financial statements:

(CZKm)	2016		2015	
	Carrying value	Fair value	Carrying value	Fair value
<b>Financial assets</b>				
Cash and balances with central banks	57,074	57,074	117,287	117,287
Loans and receivables	783,223	790,670	579,448	587,942
Held-to-maturity investments	132,679	151,699	136,433	158,636
Other assets (Note: 25)	1,199	1,199	1,224	1,224
<b>Financial liabilities</b>				
Financial liabilities at amortised cost	931,757	932,028	812,205	811,965
Other liabilities (Note: 28)	4,684	4,684	5,467	5,467

The following table shows an analysis of assets and liabilities for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

(CZKm)	Level 1	Level 2	Level 3	Total
<b>Financial assets for which fair values are disclosed</b>				
Cash and balances with central banks	9,077	47,997	-	57,074
Loans and receivables	-	238,413	552,257	790,670
Held-to-maturity investments	149,288	-	2,411	151,699
Other assets (Note: 25)	-	1,199	-	1,199
<b>Financial liabilities for which fair values are disclosed</b>				
Financial liabilities at amortised cost	-	903,163	28,865	932,028
Other liabilities (Note: 28)	-	4,684	-	4,684

The following table shows an analysis of assets and liabilities for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2015:

(CZKm)	Level 1	Level 2	Level 3	Total
<b>Financial assets for which fair values are disclosed</b>				
Cash and balances with central banks	9,522	107,765	-	117,287
Loans and receivables	-	73,626	514,316	587,942
Held-to-maturity investments	153,599	570	4,467	158,636
Other assets (Note: 25)	-	1,224	-	1,224
<b>Financial liabilities for which fair values are disclosed</b>				
Financial liabilities at amortised cost	-	790,373	21,592	811,965
Other liabilities (Note: 28)	-	5,467	-	5,467



The following methods and assumptions were applied in estimating the fair values of the Group's financial assets and liabilities:

#### **Held-to-maturity investments**

Fair values for held-to-maturity securities are based on quoted market prices, where available. Such quotes are obtained from relevant exchanges, if exchange activity for the particular security is considered sufficiently liquid, or from reference rates averaging market maker quotes. If quoted market prices are not available, fair values are estimated from quoted market prices of comparable instruments or using the valuation model based on discounted cash flows.

#### **Loans and receivables to credit institutions and balances with central banks**

The carrying values of current account balances are equal to their fair values. The fair values of term placements with credit institutions and central banks are estimated by discounting their future cash flows using current interbank market rates, including the respective credit spread derived from the Group's own experience of probability of default and loss given default. A majority of the loans reprice within relatively short time periods, therefore, it is assumed that their carrying values approximate their fair values.

#### **Loans and receivables to other than credit institutions**

A substantial majority of the loans to customers reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values. The fair values of fixed-rate loans to customers are estimated by discounting their future cash flows using current market rates including the respective credit spread derived from the Group's own experience of probability of default and loss given default. Fair value incorporates expected future losses, while amortised cost and related impairment include only incurred losses at the end of the accounting period.

#### **Deposits received from credit institutions and subordinated liabilities**

The carrying values of current account balances are equal to their fair values. For other amounts due to credit institutions with equal to or less than one year remaining maturity, it is assumed that their carrying values approximate their fair values. The fair values of other amounts due to credit institutions are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spread.

#### **Deposits received from other than credit institutions**

The fair values of current accounts and term deposits, with equal to or less than one year remaining to maturity, approximate their carrying values. The fair values of other term deposits are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spreads.

#### **Debt securities in issue**

The fair values of bonds issued are estimated by discounting their future cash flows using Czech government bond rates adjusted by credit spread derived from market observable transactions with respective or comparable bonds. The carrying values of promissory notes and certificates of deposit approximate their fair values.

#### **Other assets and other liabilities**

A majority of other assets and liabilities have a remaining maturity equal to or less than one year or reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values.



### 33. ADDITIONAL CASH FLOW INFORMATION

#### Analysis of the balances of cash and cash equivalents as shown in the statement of financial position

(CZKm)	2016	2015
Cash and balances with central banks (Note: 15)	57,074	117,287
Loans and advances to credit institutions and central banks	239,106	75,188
Financial liabilities at amortised cost to credit institutions and central banks	(9,872)	(10,972)
Financial liabilities at amortised cost - promissory notes issued to credit institutions	(195,995)	(137,133)
<b>Cash and cash equivalents</b>	<b>90,313</b>	<b>44,370</b>

#### Change in operating assets

(CZKm)	2016	2015
Net change in financial assets held for trading	9,486	21,159
Net change in financial assets designated at fair value through profit or loss	15	3,312
Net change in available-for-sale financial assets	658	(3,527)
Net change in loans and receivables	(40,528)	(28,962)
Net change in derivatives used for hedging	(541)	1,348
Net change in other assets	21	(281)
	<b>(30,889)</b>	<b>(6,951)</b>

#### Change in operating liabilities

(CZKm)	2016	2015
Net change in financial liabilities held for trading	10,075	(39,654)
Net change in financial assets designated at fair value through profit or loss	1,620	-
Net change in financial liabilities at amortised cost	61,452	25,429
Net change in derivatives used for hedging	(242)	(1,213)
Net change in other liabilities	182	411
	<b>73,087</b>	<b>(15,027)</b>

#### Non-cash items included in profit before tax

(CZKm)	2016	2015
Depreciation and amortisation (including investment property)	1,268	621
Amortisation of discounts and premiums of investment securities	918	550
Net change in fair value adjustments of the hedged items in portfolio hedge	839	(387)
Allowances and provisions for credit losses (Note: 12)	617	983
Depreciation related to operating leases assets (Note: 22)	356	270
Impairment on intangible assets (Note: 12)	74	-
Creation of provisions	37	(226)
Impairment on property, plant and equipment (Note: 12)	13	1
Impairment on financial investments (Note: 12)	2	24
Impairment on other assets (Note: 12)	2	(2)
Impairment on goodwill (Note: 12)	-	66
Impairment on non-current assets held-for-sale (Note: 12)	-	9
Foreign exchange differences in held-to-maturity investments	(129)	530
Share of profit of associates and joint ventures	(696)	(687)
Other	202	378
	<b>3,503</b>	<b>2,130</b>

### 34. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The following table sets out the financial assets and liabilities of the Group by expected remaining maturity as at 31 December 2016:

(CZKm)	Less than 1 year	1 year to 5 years	More than 5 years	Without maturity	Total
<b>ASSETS</b>					
Cash and balances with Central banks (Note: 15)	47,997	-	-	-	<b>47,997</b>
Financial assets held for trading					
Financial derivatives	3,761	6,434	2,422	-	<b>12,617</b>
Other than financial derivatives	1,164	1,802	4,424	1	<b>7,391</b>
Financial assets designated at fair value through profit or loss	-	-	-	-	-
Available-for-sale financial assets	13,824	12,967	29,731	416	<b>56,938</b>
Loans and receivables	356,756	165,438	261,029	-	<b>783,223</b>
Fair value adjustments of the hedged items in portfolio hedge	563	289	-	-	<b>852</b>
Held-to-maturity investments	18,644	64,651	49,384	-	<b>132,679</b>
Derivatives used for hedging	2,732	6,946	1,978	-	<b>11,656</b>
Other assets (Note: 25)	1,199	-	-	-	<b>1,199</b>
<b>Total carrying value</b>	<b>446,640</b>	<b>258,527</b>	<b>348,968</b>	<b>417</b>	<b>1,054,552</b>
<b>LIABILITIES</b>					
Financial liabilities held for trading					
Financial derivatives	3,568	6,531	2,169	-	<b>12,268</b>
Other than financial derivatives	18,744	6,718	2,314	-	<b>27,776</b>
Financial liabilities designated at fair value through profit or loss	57	1,248	315	-	<b>1,620</b>
Financial liabilities at amortised cost	325,267	292,979	313,511	-	<b>931,757</b>
Fair value adjustments of the hedged items in portfolio hedge	545	2,938	1,313	-	<b>4,796</b>
Derivatives used for hedging	2,764	5,616	2,152	-	<b>10,532</b>
Other liabilities (Note: 28)	4,684	-	-	-	<b>4,684</b>
<b>Total carrying value</b>	<b>355,629</b>	<b>316,030</b>	<b>321,774</b>	<b>-</b>	<b>993,433</b>

The following table sets out the financial assets and liabilities of the Group by expected remaining maturity as at 31 December 2015:

(CZKm)	Less than 1 year	1 year to 5 years	More than 5 years	Without maturity	Total
<b>ASSETS</b>					
Cash and balances with Central banks (Note: 15)	107,765	-	-	-	<b>107,765</b>
Financial assets held for trading					
Financial derivatives	3,935	5,738	1,731	-	<b>11,404</b>
Other than financial derivatives	6,032	8,028	4,024	6	<b>18,090</b>
Financial assets designated at fair value through profit or loss	15	-	-	-	<b>15</b>
Available-for-sale financial assets	5,570	20,985	32,076	1,330	<b>59,961</b>
Loans and receivables	197,718	146,454	235,276	-	<b>579,448</b>
Fair value adjustments of the hedged items in portfolio hedge	420	537	-	-	<b>957</b>
Held-to-maturity investments	10,543	72,041	53,849	-	<b>136,433</b>
Derivatives used for hedging	2,582	6,992	2,326	-	<b>11,900</b>
Other assets (Note: 25)	1,224	-	-	-	<b>1,224</b>
<b>Total carrying value</b>	<b>335,804</b>	<b>260,775</b>	<b>329,282</b>	<b>1,336</b>	<b>927,197</b>
<b>LIABILITIES</b>					
Financial liabilities held for trading					
Financial derivatives	4,145	5,947	2,090	-	<b>12,182</b>
Other than financial derivatives	11,752	3,688	2,348	-	<b>17,788</b>
Financial liabilities at amortised cost	253,875	266,157	292,173	-	<b>812,205</b>
Fair value adjustments of the hedged items in portfolio hedge	609	2,137	1,316	-	<b>4,062</b>
Derivatives used for hedging	2,685	5,723	2,366	-	<b>10,774</b>
Other liabilities (Note: 28)	5,467	-	-	-	<b>5,467</b>
<b>Total carrying value</b>	<b>278,533</b>	<b>283,652</b>	<b>300,293</b>	<b>-</b>	<b>862,478</b>

### 35. CONTINGENT ASSETS, LIABILITIES AND COMMITMENTS

#### Contingent assets

Based on a court ruling, the Group recovered a written-off loan amounting to CZK 485 m in 2007. Due to the uncertainty regarding the continuing court proceedings following the appeal by the counterparty against the decision, the Group will not recognise this amount in the statement of income until the final court decision regarding the Group's claim. In 2011, the original court ruling was cancelled and the legal case was passed to the court in the first instance for new judicial proceedings. Based on that decision, the Group returned the expenses compensation of CZK 3 m from the total received amount from the original court case to the counterparty. Judicial proceeding is continuing at the Supreme court.

#### Contingent liabilities and commitments

The contingent liabilities and commitments at 31 December 2016 and 2015 are as follows:

(CZKm)	2016	2015
Loan commitments – irrevocable (Note: 40.2)	118,292	107,224
Loan commitments – revocable	44,732	41,861
Financial guarantees (Note: 40.2)	30,243	28,193
Other commitments (Note: 40.2)	1,324	1,381
	<b>194,591</b>	<b>178,659</b>
Provisions for loan commitments and guarantees (Notes: 29, 40.2)	232	286

Revocable loan commitments are such commitments in which the Group may at any time limit the amount that may be drawn under the credit limit. Further the Group may not provide any drawdown under the credit facility requested by the client or the Group can suspend further drawdowns under the credit facility all together. The Group can do so with or without specifying the reason, giving a prior notice or stipulating any time limit. Loan commitments which do not meet the above definition are assessed as irrevocable.

The contractual amounts described above represent the maximum credit risk that would arise if the contracts were fully drawn, the customers defaulted and the value of any existing collateral became worthless. Many of the commitments are collateralised and most are expected to expire without being drawn upon; therefore, the total commitment contractual amounts do not necessarily represent the risk of loss or future cash requirements (Note: 40.3).

The Group is obliged by law to guarantee the positive results and equity position of the Transformed fund. With regard to the conservative investment policy and investment limits of the Transformed fund the management of the Group is convinced it is not probable the guarantee will be used.

### Litigation

Other than the litigations, for which provisions have already been made (Note: 29), the Group is named in and is defending a number of legal actions in various jurisdictions arising in the ordinary course of business. The Group does not believe that the ultimate resolution of these legal actions will result in a material impact on the financial position of the Group.

The Group is subject to a number of claims in the context of the IPB acquisition amounting to tens of billions of Czech Crowns. The Group believes that such claims are unfounded. In addition, the Group believes that potential risk arising from such claims is covered by guarantee agreements issued by the institutions of the Czech state.

Further, the Group has initiated a number of legal actions to protect its assets.

### Taxation

Czech tax legislation, interpretation and guidance are still evolving. Consequently, under the current taxation environment, it is difficult to predict the interpretations that the respective tax authorities may apply in a number of areas. As a result, the Group has used its current understanding of the tax legislation in the design of its planning and accounting policies. The effect of the uncertainty cannot be quantified.

### Operating lease commitments (Group is the lessee)

Future minimum lease payments under operating leases related to information technologies, land and buildings are as follows:

(CZKm)	2016	2015
Not later than 1 year	483	593
Later than 1 year and not later than 5 years	880	1,054
Later than 5 years	195	176
	<b>1,558</b>	<b>1,823</b>

Future minimum sublease payments amounted to CZK 4 m as at 31 December 2016 (31 December 2015: CZK 6 m).

The operating leases related to land and buildings can be technically cancelled under Czech law; however, the Group is commercially bound to continue with these leases for the periods set out above.

**Operating lease receivables (Group is the lessor)**

Future minimum lease payments (including sublease payments) under operating leases related to land and buildings and movables are as follows:

(CZKm)	2016	2015
Not later than 1 year	2,060	838
Later than 1 year and not later than 5 years	1,923	1,095
Later than 5 years	351	12
	<b>4,334</b>	<b>1,945</b>

These operating leases can be technically cancelled under the Czech law; however, the lessees are commercially bound to continue with these leases for the periods set out above.

**Commitments**

Capital expenditure contracted at the balance sheet date but not yet incurred in respect of the Group's new head office building is CZK 1,832 m (2015: CZK Nil).

**36. REPURCHASE AGREEMENTS AND COLLATERAL**

The following table shows an analysis of the loans the Group has made to counterparties in reverse repurchase agreements and loans, where the Group is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, according to the lines of the statement of financial position in which they are included:

(CZKm)	2016	2015
<b>Financial assets</b>		
Loans and receivables	237,993	72,846
	<b>237,993</b>	<b>72,846</b>

Under reverse repurchase agreements, the Group obtains legal ownership of the respective collateral received and, thus, is permitted to use the collateral; however, the same collateral must be delivered back to the borrower of the funds on maturity.

Under loans, where the Group is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral (collaterals of factoring loans), the Group obtains legal ownership of the respective collateral received and, thus, is permitted to use the same collateral. The Group has no obligations to return collateral to the borrower of the funds on maturity.

The fair value of financial assets accepted as collateral as at 31 December 2016 was CZK 239,292 m, of which CZK 16,596 m has been either sold or repledged (31 December 2015: CZK 74,420 m and CZK 10,046 m, respectively).

The following table shows an analysis of the loans the Group has received from counterparties in repurchase agreements according to the lines of the statement of financial position in which they are included:

(CZKm)	2016	2015
<b>Financial liabilities</b>		
Financial liabilities at amortised cost	9,452	-
	<b>9,452</b>	<b>-</b>

The Group contracts repo operations under the standard conditions currently applied on the market. Amounts of financial assets pledged as collateral in repo transactions and securities lending are described in Financial assets at fair value through profit or loss (Note: 16) and Financial investments (Note: 17).

### 37. OFFSET FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The following table shows an analysis of the financial assets and liabilities of the Group that have been set-off or that are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2016:

(CZKm)	Gross amounts of recognised financial instrument	Gross amounts of recognised financial instrument set-off	Net amounts of financial instrument presented in the balance sheet
<b>FINANCIAL ASSETS</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	19,087	-	19,087
Derivatives not set-off that are not subject to an enforceable master netting arrangement	5,186	-	5,186
<b>Total trading and hedging derivatives</b>	<b>24,273</b>	<b>-</b>	<b>24,273</b>
Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement	237,993	-	237,993
<b>Total repurchase agreements (Note: 36)</b>	<b>237,993</b>	<b>-</b>	<b>237,993</b>
Other financial assets not set-off that are not subject to an enforceable master netting arrangement	1,199	-	1,199
<b>Total other financial assets (Note: 25)</b>	<b>1,199</b>	<b>-</b>	<b>1,199</b>
<b>FINANCIAL LIABILITIES</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,647	-	20,647
Derivatives not set-off that are not subject to an enforceable master netting arrangement	2,153	-	2,153
<b>Total trading and hedging derivatives</b>	<b>22,800</b>	<b>-</b>	<b>22,800</b>
Repurchase agreements not set-off that are subject to an enforceable master netting arrangement	9,452	-	9,452
<b>Total repurchase agreements (Note: 36)</b>	<b>9,452</b>	<b>-</b>	<b>9,452</b>
Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement	4,684	-	4,684
<b>Total other financial liabilities (Note: 28)</b>	<b>4,684</b>	<b>-</b>	<b>4,684</b>

The following table shows an analysis of the financial assets and liabilities of the Group that have been set-off or that are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2015:

(CZKm)	Gross amounts of recognised financial instrument	Gross amounts of recognised financial instrument set-off	Net amounts of financial instrument presented in the balance sheet
<b>FINANCIAL ASSETS</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	18,591	-	18,591
Derivatives not set-off that are not subject to an enforceable master netting arrangement	4,713	-	4,713
<b>Total trading and hedging derivatives</b>	<b>23,304</b>	<b>-</b>	<b>23,304</b>
Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement	72,846	-	72,846
<b>Total repurchase agreements (Note: 36)</b>	<b>72,846</b>	<b>-</b>	<b>72,846</b>
Other financial assets set-off in the balance sheet	221	221	-
Other financial assets not set-off that are not subject to an enforceable master netting arrangement	1,224	-	1,224
<b>Total other financial assets (Note: 25)</b>	<b>1,445</b>	<b>221</b>	<b>1,224</b>
<b>FINANCIAL LIABILITIES</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,676	-	20,676
Derivatives not set-off that are not subject to an enforceable master netting arrangement	2,280	-	2,280
<b>Total trading and hedging derivatives</b>	<b>22,956</b>	<b>-</b>	<b>22,956</b>
Other financial liabilities set-off in the balance sheet	221	221	-
Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement	5,467	-	5,467
<b>Total other financial liabilities (Note: 28)</b>	<b>5,688</b>	<b>221</b>	<b>5,467</b>

The following table shows an analysis of the financial assets and liabilities of the Group that have not been set-off and are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2016:

(CZKm)	Net amounts of financial assets presented in the balance sheet	Amounts not set-off in the balance sheet			Total net amount
		Financial instruments	Cash collateral	Securities collateral	
<b>FINANCIAL ASSETS</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	19,087	17,747	1,054	-	286
Debt securities pledged as collateral in repo transaction not set-off that are subject to an enforceable master netting arrangements	9,452	9,452	-	-	-
<b>Total carrying value</b>	<b>28,539</b>	<b>27,199</b>	<b>1,054</b>	<b>-</b>	<b>286</b>
<b>FINANCIAL LIABILITIES</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,647	17,747	2,699	-	201
Repurchase agreements not set-off that are subject to an enforceable master netting arrangement	9,452	-	-	9,452	-
<b>Total carrying value</b>	<b>30,099</b>	<b>17,747</b>	<b>2,699</b>	<b>9,452</b>	<b>201</b>

The following table shows an analysis of the financial assets and liabilities of the Group that have not been set-off and are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2015:

(CZKm)	Net amounts of financial assets presented in the balance sheet	Amounts not set-off in the balance sheet			Total net amount
		Financial instruments	Cash collateral	Securities collateral	
<b>FINANCIAL ASSETS</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	18,591	17,217	993	-	381
<b>Total carrying value</b>	<b>18,591</b>	<b>17,217</b>	<b>993</b>	<b>-</b>	<b>381</b>
<b>FINANCIAL LIABILITIES</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,676	17,217	3,234	-	225
<b>Total carrying value</b>	<b>20,676</b>	<b>17,217</b>	<b>3,234</b>	<b>-</b>	<b>225</b>



The amounts in both tables are subject to master netting agreement in accordance with International Swaps and Derivatives Association (ISDA), however with no intention to settle them on a net basis.

### 38. RELATED PARTY DISCLOSURES

A number of transactions are executed with related parties in the normal course of business.

The outstanding balances of assets from related party transactions as at 31 December 2016 are as follows:

(CZKm)	Financial assets held for trading	Financial assets designated at fair value through profit or loss	Loans and receivables	Derivatives used for hedging	Other assets
Directors / Top management	-	-	-	-	-
KBC Bank	2,892	-	1,311	7,903	-
Entities under common control					
ČSOB SK	1	-	51	-	15
KBC Investment Limited	211	-	-	-	-
KBC Securities NV	-	-	117	-	1
Other	33	-	136	-	-
Associates					
ČSOB AM	-	-	130	-	-
ČSOB Pojišťovna	396	-	-	-	26
Joint ventures					
ČMSS	-	-	40	-	41

The outstanding balances of liabilities from related party transactions as at 31 December 2016 are as follows:

(CZKm)	Financial liabilities held for trading	Financial liabilities at amortised cost	Derivatives used for hedging	Other liabilities
Directors / Top management	-	96	-	57
KBC Bank	3,219	200,717	8,616	-
Entities under common control				
ČSOB SK	4	42	-	-
KBC Investment Limited	35	182	-	-
KBC Securities NV	111	-	-	1
Other	12	92	-	37
Associates				
ČSOB AM	-	594	-	9
ČSOB Pojišťovna	21	2,594	-	-
Joint ventures				
ČMSS	-	7,545	-	-

The outstanding balances of assets from related party transactions as at 31 December 2015 are as follows:

(CZKm)	Financial assets held for trading	Financial assets designated at fair value through profit or loss	Loans and receivables	Derivatives used for hedging	Other assets
Directors / Top management	-	-	-	-	-
KBC Bank	2,685	-	1,277	7,439	1
Entities under common control					
ČSOB SK	157	-	34	1	-
KBC Internationale Financieringsmij NV	149	-	-	-	-
KBC Securities NV	-	-	238	-	1
Other	159	15	145	-	-
Associates					
ČSOB AM	-	-	35	-	-
ČSOB Pojišťovna	413	-	-	-	45
Joint ventures					
ČMSS	-	-	40	-	56

The outstanding balances of liabilities from related party transactions as at 31 December 2015 are as follows:

(CZKm)	Financial liabilities held for trading	Financial liabilities at amortised cost	Derivatives used for hedging	Other liabilities
Directors / Top management	-	60	-	59
KBC Bank	2,621	138,608	8,546	-
Entities under common control				
ČSOB SK	3	36	-	-
KBC Group	-	1	-	983
KBC Securities NV	-	134	-	1
Other	26	188	-	-
Associates				
ČSOB AM	-	133	-	12
ČSOB Pojišťovna	9	2,665	-	-
Joint ventures				
ČMSS	-	8,213	-	-

The outstanding balances of assets and liabilities with KBC Bank NV and the entities under common control principally comprise the fair value of derivative financial instruments, debt instruments and repo transactions.

The Group provides banking services to its associates and joint ventures such as provided loans, overdrafts, interest bearing deposits and current accounts as well as other services.

The outstanding balances, described above, arose in the ordinary course of business and are subject to the substantially same terms, including interest rates and security, as for comparable transactions with third party counterparties.

The balances of interest income and expense from related party transactions for the year ended 31 December are as follows:

(CZK m)	2016		2015	
	Interest income	Interest expense	Interest income	Interest expense
Directors / Top management	-	-	-	-
KBC Bank	1,106	683	1,290	1,068
Entities under common control				
ČSOB SK	3	1	9	-
KBC Internationale Financieringsmij NV	-	-	8	-
Other	2	-	2	-
Associates				
ČSOB Pojišťovna	-	38	-	42
Joint ventures				
ČMSS	1	122	53	215

The balances of fee and commission income and expenses from related party transactions for the year ended 31 December are as follows:

(CZK m)	2016		2015	
	Fee and commission income	Fee and commission expense	Fee and commission income	Fee and commission expense
KBC Bank NV	83	1	62	10
Entities under common control				
ČSOB SK	-	5	-	30
KBC Group	-	-	-	35
KBC Securities NV	18	32	23	39
Other	-	4	-	4
Associates				
ČSOB AM	466	39	455	34
ČSOB Pojišťovna	274	4	279	6
Joint ventures				
ČMSS	14	41	6	42

In accordance with the Group strategy, information and communication services were reintegrated from the KBC Group Czech Branch back to ČSOB in 2015. Based on the acquisition agreement, concluded between the ČSOB and the KBC Group, selected activities and processes of the KBC Group Czech Branch, including employees (Note: 10), assets and liabilities related to the ICT function, were acquired by the Bank on 31 December 2015 (Note: 3).

Effective from 1 July 2009, the Group concluded an office space rental agreement and a service level agreement on the provision of administration services, such as human resources and accounting services, with KBC Group. In 2016, the Group received income of CZK Nil (2015: CZK 72 m) from rental payments and related services, received CZK 68 m (2015: CZK 59 m) from the provision of administration services and paid expense of CZK 609 m (2015: CZK 3,321 m) for IT services, including rental expenses on information technologies.

In 2016, the Group received income of CZK 569 m (2015: CZK 87 m) from ČSOB SK and ČSOB Pojišťovna arising from providing services and support in the following areas such as: ICT services, electronic banking, cards, payment processing, financial management and risk management.

The outstanding contractual balances of the contingent assets and liabilities to the related parties at 31 December are as follows:

(CZKm)	2016		2015	
	Guarantees received	Guarantees given	Guarantees received	Guarantees given
KBC Bank NV	2,222	194	2,596	191
Entities under common control				
ČSOB SK	2,343	23	1,815	145
Kereskedelmi és Hitelbank	232	23	270	23
Associates				
ČSOB Pojišťovna	-	-	-	1

The outstanding balances of guarantees received from KBC Bank and the entities under common control principally comprise sub-participation arrangements and other compensation commitments.

### 39. EVENTS AFTER THE REPORTING PERIOD

There were no events after the reporting period.

## 40. RISK MANAGEMENT

### 40.1 Introduction

Risk is an inherent part of the Group's activities, and risk and capital management is critical to the results of operations and financial condition of the Group.

The principal risks that the Group faces are credit risk, liquidity risk, operational and other non-financial risks, market risk subdivided into trading (trading portfolio) and non-trading (credit and investment portfolio) risks. The Group manages risk and capital through a system of ongoing identification, measurement and monitoring, subject to risk and capital limits and other controls. The Group primarily allocates capital to each subsidiary and business unit with the aim of achieving an acceptable balance between risk and return. The Group's risk and capital management system is based on a risk strategy determined by the Bank's Board of Directors and is consistent with the KBC Group's risk and business strategy, with a primary focus on the early identification and management of risks and trends. The Group maintains and develops its risk and capital management system to meet its ongoing internal risk and capital management needs and to comply with all legal and other regulatory (capital) requirements, including Basel III, and the regulations of the CNB, European Central Bank (ECB), European Banking Authority (EBA) and other relevant bodies.

#### Risk and Capital Management Organization

##### *Main Principles of Risk and Capital Management Organization*

The Group's risk and capital management organization is based on the principle of segregating risk origination and acceptance from risk monitoring and control. The risk and capital management and control functions are designed to be exercised independently of the front office functions. Nevertheless, the front office is engaged in risk and capital management and control functions and is responsible in the first instance for risk control in all risk and capital management areas. The aim of risk and capital management at the Group is to closely cooperate with the business in achieving an acceptable balance between return and risk, as opposed to focusing solely on minimizing risks.

Risk and capital management within the Group is centralized at the ČSOB level. Nevertheless, each subsidiary, associate and joint venture of ČSOB also has a risk control and management unit, the responsibilities and size of which are tailored to the requirements applicable to that subsidiary under the Group's risk and capital management strategy and policies. Any decisions taken by the Group are considered by the subsidiaries, associates and joint ventures of ČSOB as recommendations and require final approval by the appropriate decision making bodies of these subsidiaries, associates and joint ventures, as applicable.

The risk and capital management governance model that was implemented within the Group in 2011 is based on the following general principles:

- the business, including both sales and credit departments, should be responsible in the first instance for risk and capital management, and must systematically take into account risk and capital management considerations into all its decisions;
- risk and capital management, and risk reporting, should be performed consistently within the entire KBC Group, including the Group, and management incentives should be linked to risk and capital adjusted measures, and aligned consistently within the entire KBC Group;
- the risk and capital management governance structure should be an independent and vertically integrated structure aimed at ensuring that risk and capital management considerations are properly reflected in the business decisions within the Group;
- risk and capital management should closely cooperate with the business with the aim of achieving an acceptable balance between return and risk, as opposed to focusing only on minimising risks;
- the Board of Directors should determine the risk appetite of the Group within which the business has the right to take risks and beyond which the Chief risk officer (CRO) can intervene; and
- the risk reporting processes should be uniform and insightful to allow for the adoption of risk and capital management decisions at both strategic and implementation levels.

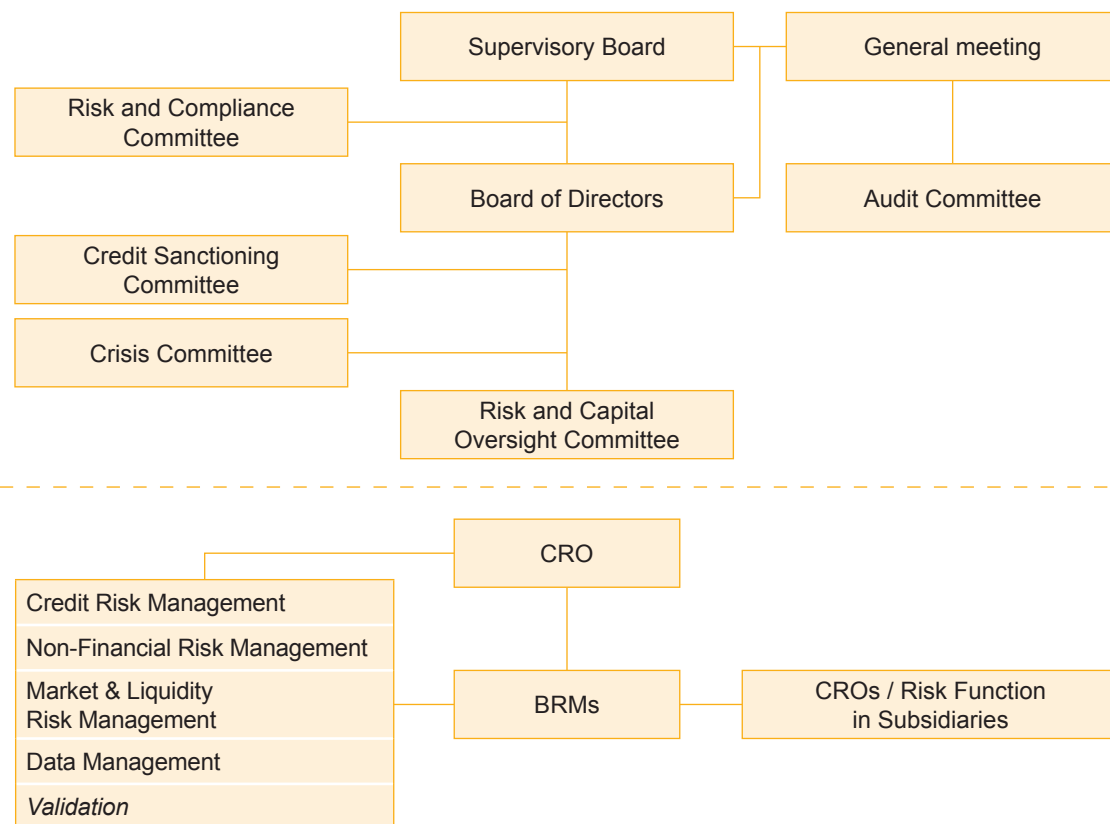
The principles described above establish a governance structure, within which:

- (i) the Board of Directors is responsible for determining the risk appetite of the Group, and capital allocation within the Group, by establishing measurable risk and capital parameters, which must be followed in all business activities,
- (ii) the Risk and Capital Oversight Committee (RCOC) is responsible for proposing the risk appetite and capital allocation to the Board of Directors, translating the approved risk appetite and capital allocation into numerical risk limits within its delegated authority, and regular monitoring of risk and capital against these limits,
- (iii) the CRO, together with the Risk Function, as described below, is responsible for designing the frameworks in which risk management should take place, for translating the risk limits into policies and for ensuring that monitoring systems are in place, and
- (iv) the business is responsible for taking risks within the risk and capital allocation.

### ***Risk and Capital Management Governance***

Risk and capital governance in the Group is fully embedded in the governance of the KBC Group. During 2015, a few changes were put in place to take account of changes in the organisational structure of ČSOB. Most importantly, the Risk and Compliance Committee was established as a sub-committee of the Supervisory Board with a specific focus on risk management and compliance matters.

The chart below depicts an overview of the principal bodies of the risk and capital governance model in the Group.



The Group operates a three-line of defense risk management model whereby front office functions, risk management oversight and assurance roles are played by functions independent of one another. The model is characterised primarily by:

- the Board of Directors, assisted by the Audit Committee, Supervisory Board and its Committees,
- the Risk and Capital Oversight Committee,
- an independent Chief Risk Officer, supported by the independent Risk Function, and
- risk-aware business people, who act as the first line of defence ensuring that a risk control environment is established as part of day-to-day operations.

### *Supervisory Board*

In its main role, the Supervisory Board oversees whether the governance of the Group is efficient, comprehensive and adequate, and regularly evaluates the findings obtained from this activity. Its oversight role consists in providing constructive challenge when developing the strategy of the Group; monitoring of the performance of the management function and the realisation of agreed goals and objectives, business and risk strategies; and ensuring the integrity of the financial information, effective risk management and internal controls (including proper segregation of duties within the Group).

The Supervisory Board regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

The Supervisory Board:

- Oversees whether the system of risk governance is efficient, comprehensive and adequate;
- Regularly discuss matters concerning the risks to which the Bank is or might be exposed;
- Continuously oversees and assures itself of the fulfilment of the risk management strategy and of the operational control's reliability;
- Critically and constructively participates in the evaluation of the management of risks;
- Comments on a proposal (of the KBC Group CRO) to entrust as well as dismiss a natural person with the ensuring of the performance of the risk management function, stipulates policies governing remuneration of that person and assesses the activities of the person.

### *Risk and Compliance Committee*

The Supervisory Board established the Risk and Compliance Committee which is mainly responsible for advising the Supervisory Board on the Group's overall current and future risk profile, appetite and strategy, and for overseeing the implementation of that strategy.

The Committee regularly discusses risk management and compliance related matters and communicates with the Group's risk control function and Chief Risk Officer. In addition, the Risk and Compliance Committee assists the Supervisory Board in the establishment of sound remuneration policies and practices, examines whether incentives provided by the remuneration system take into consideration risk, capital, liquidity likelihood and timing of earnings.

The Committee reviews the activities, structure, independence, professionalism and expertise of Risk management.

The Committee regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

### *Audit Committee*

The Audit Committee, inter alia, monitors the effectiveness of the Group's internal control, internal audit, risk management systems, establishment of accounting policies by the institution and procedures in preparing the financial statements and consolidated financial statements of the Group.

With regards to external audit, the Committee oversees the Group's external auditors, monitors the process of mandatory audits of the financial statements and consolidated financial statements, assesses the independence of statutory auditors and the auditing firm(s), recommends for approval by the management body the appointment, compensation and appointment of the external auditors; review and approves the audit scope and frequency; review audit reports.

In addition to that the Committee checks that the management body in its management function takes necessary corrective actions in a timely manner to address control weaknesses, non-compliance with laws, regulations and policies, and other problems identified by the auditors.

### *Board of Directors (BoD)*

The Board of Directors has the overall responsibility for the Group, proposes its strategic direction within applicable legal and regulatory framework taking into account the institution's long-term financial interests and solvency; ensures the effective implementation of the strategy and is responsible for the day-to-day running of the Group.

The Board of Directors generally ensures that comprehensive and adequate internal control and risk governance system is established, good functioning and efficient, in its entirety and in parts. With regards to the risk management function, the Board of Directors:

- (i) Ensures earmarking of adequate and sufficient capacities for management of significant risks, capital and liquidity management, internal models and validations/reviews of such models;
- (ii) Approves and regularly evaluates the implementation of:
  - Risk Management Charter,
  - Risk Appetite of ČSOB,
  - Result of Risk Scan,
  - Risk Management Strategy,
  - Risk Management Framework (including risk specific frameworks),
  - Limit Book and Framework,
  - Internal Capital Adequacy Assessment Process and Capital Adequacy Policy,
  - Recovery and Resolution plan,
  - Information Security Strategy;
- (iii) Evaluates the overall functioning and efficiency of the internal control and governance system (Internal Control Assessment to ČSOB Supervisory Board), and ensures appropriate steps to rectify the potential identified shortcomings.



On the basis of monthly integrated risk management reports prepared by the Risk Function, the Board of Directors is also responsible for monitoring whether the Group's risk profile is in line with the Group's risk appetite, limits system and making decisions on risk and capital management issues that may be escalated to its attention by the CRO or the RCOC, as described below.

#### *Risk and Capital Oversight Committee (RCOC)*

The RCOC assists the Board of Directors in monitoring the Group's risk and capital management exposures against the limits set by the Board of Directors. The key responsibilities of the RCOC regarding risk and capital management matters are to:

- (i) propose to the Board of Directors the Bank's Risk Appetite;
- (ii) propose to the Board of Directors a framework of limits consistent with the Bank's Risk Appetite, within which Risk and Capital will be managed;
- (iii) provide an integrated view on Risk exposure against Risk Appetite/Limits and identify/report on 'hidden risks' (including concentration); In the event of Risk exposure being in excess of limit(s), to recommend to the BoD material mitigating actions and decide on non-material mitigating actions to bring Risk exposure back in line;
- (iv) periodically review limits and, as necessary, to recommend to the BoD material changes in limit (s) and to decide on non – material limit changes;
- (v) monitor market context, solvency, liquidity, risk/return profile, balance sheet profile, maturity transformation and structural interest rate exposure;
- (vi) monitor capital adequacy and usage of Regulatory and Economic Capital.

The RCOC is responsible for the whole ČSOB group. In case of subsidiaries or entities that have a separate legal structure, the decisions of the RCOC are to be considered as advices to the Management Board of those entities.

The RCOC reviews regular risk reports prepared by the Risk Function, which are then submitted to the Board of Directors, the Audit Committee and the Supervisory Board. These reports form the basis for the risk monitoring process. Further ad hoc reports may be prepared and submitted, where relevant. The CRO is the chairman and the CFO is the vice-chairman of the Committee.

#### *Chief Risk Officer (CRO)*

The Chief Risk Officer (CRO), who is a member of the Board of Directors, is in general responsible for the identification, assessment and reporting of risks arising within operations across all business and all risk types, and has a direct management responsibility for the following risk management functions / departments:

- (i) Credit Risk Management;
- (ii) Market and Liquidity Risk Management;
- (iii) Non-financial Risk Management;
- (iv) Validations; and
- (v) Data Management.

The CRO:

- (i) Ensures that risk management processes are effective and efficient, promotes a culture of risk aware business conduct and prudent risk management;
- (ii) Ensures compliance with Group (KBC) and regulatory requirements in the field of risk management;
- (iii) Recommends the need for action to address risk & capital issues raised in internal reports;
- (iv) Inputs to corrective actions to address local underperformance versus targets and agree to final actions to ensure within risk playing field;
- (v) Assess the rate and structure of risk undertaken and the impact thereof on the performance and stability;



- (vi) Coordinates the field of continuity management for the business;
- (vii) Provides risk and capital reporting to internal (senior management, Board of Directors, Risk and Compliance Committee, Subsidiaries) and external clients (KBC, CNB);
- (viii) Presents information concerning the developments in the field of risk management to ČSOB and KBC management;
- (ix) Advises on risk related matters to Management Board of subsidiaries within the Group that have a separate legal structure.

The key strategic and governance responsibilities of the CRO are to:

- (i) Recommend Risk Governance structure and roles;
- (ii) Decide the structure of the Risk Function;
- (iii) Input to the Risk Appetite;
- (iv) Input to the corporate Strategy / strategic plans (including performance targets) development and agree to final Strategy to ensure within risk playing field;
- (v) Recommend Risk and Capital Management Strategy;
- (vi) Input to limits and delegation of authority setting within and below BoD delegation and agree to final decision to ensure within risk playing field;
- (vii) Input to capital and funding allocation and agree to final allocation to ensure within risk playing field.

The CRO, in its role has following key execution activities:

- (i) Recommend and decide on changes to the Risk Function owned frameworks;
- (ii) Decide on validation of transactional models for risk management;
- (iii) Input to guidelines for portfolio and transactional model development;
- (iv) Input or decide (in line with the delegation rules) on mitigating actions for limit overruns and agree to final decision to ensure within risk playing field;
- (v) Recommend and/or decide ex-post actions to address compliance issues with risk frameworks;
- (vi) Ensure the process of assessment and evaluation of the regulatory / internally determined capital adequacy and conduct stress testing;
- (vii) Input to day to day business decisions as a trusted advisor;
- (viii) Agree to risk taking decisions outside of the risk playing field with the right to call "time out".

The CRO may suspend any decisions of any department or committee, or any business unit or sub-unit, affecting the risk or capital position of the Group by escalating it to the RCOC or the Board of Directors.

#### *Risk Function*

The Risk Function provides independent oversight of the management of risks inherent in the Group's activities. The function is generally responsible for ensuring that effective processes are in place for:

- (i) Identifying current and emerging risks;
- (ii) Developing risk assessment and measurement systems;
- (iii) Establishing policies, practices and other control mechanisms to manage risks;
- (iv) Developing risk tolerance limits for Senior Management and Board approval;
- (v) Monitoring positions against approved risk tolerance limits; and
- (vi) Reporting results of risk monitoring to Senior Management and the Board.

The Risk Function is represented by the following departments reporting to the CRO - Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management, Data Management and Validations. The departments have the following roles:

*Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management*

Particular risk management departments are responsible for managing credit risk, market risk, liquidity risk and operational risk. In particular, they are responsible for:

- (i) ensuring that the risk frameworks specific to these types of risks are in place and properly implemented;
- (ii) monitoring the risk limits and proposing changes to these risk limits or corrective actions to be taken in response to breaches of these risk limits;
- (iii) information security frameworks for informational risk, including cyber risk, and the monitoring of these risks;
- (iv) integrated risk reporting (see Risk Monitoring and Reporting below);
- (v) the management of economic capital.

Within the Non-financial Risk Management department, the information security officer is responsible for determining the risk frameworks for informational risk, including cyber risk, and the monitoring of these risks.

*Data Management*

Data Management is responsible for supporting all the other departments forming the Risk Function in data management and reporting. In particular:

- (i) maintaining all ICT applications needed for the performance of risk and capital management;
- (ii) designing the technical ICT architecture in cooperation with the ICT; and
- (iii) performing activities aimed at ensuring the correct flow of data needed for proper risk and capital monitoring.

Data Management is responsible for risk data governance and also forms the link between the requirements of the Risk Function and ICT.

*Central Credit risk and loss Measurement Validation*

Central Credit risk and loss Measurement Validation focuses on reducing of model risk and seeks a group-wide consistency by providing a well-founded, intelligible and timely independent second opinion and methodological guidance on models for risk measurement and provisioning to their owners, decision bodies and modellers.

*Risk Integration*

Furthermore, specific team within the Risk Function covers overarching aspects of risk management. It's mandate is to provide an increased focus on holistic risk management and cross-risk oversight to further enhance our risk management. Key objectives are to:

- (i) drive key strategic cross-risk initiatives and establish greater cohesion between defining portfolio strategy and governing execution, including regulatory adherence and recovery planning;
- (ii) provide a strategic and forward-looking perspective on the key risk issues for discussion at senior levels within the Group (risk appetite, stress testing framework);
- (iii) strengthen risk culture at the Group; and
- (iv) foster the implementation of consistent risk management standards.

Risk Integration is responsible for managing the process of measuring and monitoring risk on an integrated basis within the Group. In particular, Risk Integration performs the ICAAP process (see ICAAP Process below), including the management of economic capital, and was responsible for integrated risk reporting (see Risk Monitoring and Reporting below). Risk Integration also regularly provides reports to the supervisory section of the ČNB.

Risk Integration is also responsible for preparation of recovery plans and cooperates with regulator in preparation of resolution plan.

### *Delegation of responsibilities*

The Board of Directors has delegated responsibilities to each of the RCOC and the CRO. Such delegated authority includes the following:

- the RCOC may authorize transactions and approve risk limit exceptions described in limit book and limit book framework. The limit book and limit book framework is regularly approved by RCOC and Board of Directors.

In addition, in instances where amounts cannot be calculated or for which there is uncertainty over the exact risk exposure, the CRO may decide to submit the transaction to the RCOC.

- an authorization of the CRO is required for decisions on risk frameworks and policies
  - (i) where the risk frameworks or policies impact 5% or more of the Group's regulatory capital by risk type or a derivation thereof; and
  - (ii) where, if the regulatory capital cannot be taken as a relevant measure, the risk framework or policy impacts 2% of the Group's estimated sustainable profit for the current year.
- to the CRO, the authority to decide on matters falling below the thresholds described above. The CRO may sub-delegate this authority further to one of the departments forming the Risk Function.

Moreover, the CRO may submit to the Board of Directors, the Supervisory Board, the Risk and Compliance Committee and/or the Audit Committee issues and concerns related to the entire Group which the CRO considers to have an actual or potential material impact on the Group's risk parameters.

In addition to the risk and capital management activities performed at the Group level, each subsidiary of ČSOB also has a risk control and management unit, the responsibilities of which are tailored to the requirements applicable to the subsidiary, under the Group's risk and capital management policies.

### ***Other Departments and Committees Participating in Risk and Capital Management***

In addition to the Board of Directors, the Audit Committee, the Supervisory Board, the RCOC, the CRO and the Risk Function, the following other departments and committees are involved in day-to-day risk and capital management at the Group level:

#### *Credit Departments*

The Credit Departments are responsible for implementing and maintaining the individual credit processes within the frameworks designed by the Risk Function and the limits determined by the risk appetite and capital allocation approved by the Board of Directors. The Group has six Credit Departments, one for each of:

- (i) corporates, SMEs and banks;
- (ii) consumer finance;
- (iii) ČSOB Leasing;
- (iv) ČMSS;
- (v) Hypoteční banka; and
- (vi) ČSOB Factoring.

These departments report either to a Credit Risk Manager or the CFO. The key responsibilities of the Credits Departments are to:

- (i) approve individual credit applications;
- (ii) approve contractual documentation concerning individual credits;
- (iii) monitor credit behaviour of individual credits during their lifetime; and
- (iv) manage the work-out process in respect of individual credits.

### *Asset and Liability Management Department (ALMD)*

The ALMD is responsible for managing the assets and liabilities of the Group's investment portfolio within the frameworks designed by the Risk Function and the risk appetite and capital allocation approved by the Board of Directors. The ALMD is also primarily responsible for managing the funding and liquidity position of the Group. The ALMD reports to the CFO.

### *Internal Audit Department*

The Internal Audit Department regularly audits / assesses risk and capital management processes throughout the Group examining both the adequacy of its risk and capital management procedures and the Group's compliance with the same. The Internal Audit Department discusses the results of its assessments with management, and reports its findings and recommendations to the Board of Directors and the Audit Committee. The Internal Audit Department reports to the CEO.

### *New and Active Product Processes (NAPPs)*

Members of NAPP process are responsible for the approval of new products and their distribution and marketing, as well as for the regular review of existing products. Cross functional membership in NAPPs including control functions (the Risk Function, Finance Department, Tax Department, Legal Department, Compliance Department and Internal Audit Department) seeks to ensure that no product may be offered to the Group's customers unless all significant risks have been analysed and mitigated and residual risks have been accepted. The Group pays special attention to protecting the Group against claims arising from the mis-selling of products. As a general rule, all products as well as all distribution channels must be covered by a NAPP.

### *Credit Sanctioning Committee (CSC)*

The CSC is a committee with group-wide responsibility and authority to take decisions on individual credit applications falling within the delegated decision powers of the CSC. As such, it acts as the highest decision-making committee for the Group with respect to credit risk. The members of the CSC are the CFO, who is the CSC's chairman, and the head of the ČSOB credit and bad debts department, corporate advice and underwriting department, corporate and bank credits department, corporate specialised finance department and corporate and institutional banking department. The CSC reports to the Board of Directors.

### *Business Risk Meetings (BRMs)*

Business Risk Meetings are established for each business line in the Group where business specific risk issues are regularly discussed. The CRO has sole decision right within the delegated decision authority which can always be escalated to the Board of Directors at the request of the Board of Directors' member responsible for that area.

### *Internal Capital Adequacy Assessment Process*

The Basel Capital Accord, generally referred to as Basel II, was the first to present, a qualitatively new dimension of requirements for capital adequacy assessment at banks and other credit institutions known as the Second Pillar.

Pillar 2, inter alia, requires the institution to internally assess its capital adequacy taking into account all (material) risks it faces or may face (Internal Capital Adequacy Assessment Process – ICAAP). Basel III changed the regulatory Pillar 2 practices mainly in the area of capital planning, stress testing and risk strategies.

The ICAAP is seen as an integral part of the overall management and control system of the Group, by which ČSOB also adopts and uses reliable, effective and comprehensive strategies and procedures to:

- continually set and assess the need for internal capital; and
- plan and maintain internal capital resources, of the amount, structure and allocation to sufficiently cover the risks that ČSOB is or may be exposed to (internally set and maintained capital adequacy).

As part of the KBC group, ČSOB has adopted a unified KBC group ICAAP approach, approved by the top managements of both KBC and ČSOB, taking into account requirements of the home regulator (the Czech National Bank) as well as the host regulator (the European Central Bank).

In 2015, KBC developed a new internal economic capital model, which was also adopted by the Group. The main difference between the previous and the current models is the change from fully fair value based approach to accounting value based approach. The new model was developed taking into account the IFRS 9, which will be implemented in 2018.

Regularly, at least once a year, the Board of Directors evaluates the ICAAP, focusing on an overall assessment of whether the strategies and procedures used are reliable, effective, comprehensive and still proportionate to the nature, scale and complexity of the Group's activities. The Board of Directors also discusses and approves any ICAAP changes and modifications. Moreover, results of Internal Capital Model which is currently used for internal calculation of the ČSOB capital adequacy are quarterly reported to the Board of Directors.

When setting and assessing - on an ongoing basis - its internal capital needs, and planning and maintaining its internal capital resources, ČSOB uses an accounting-value approach, while taking into account quantitative and qualitative inputs and methods, including its own expert analyses, forecasts and scenarios proportionate to the nature, scale and complexity of its activities and the risks associated with them.

ICAAP is forward looking, i.e. it also takes into account the risks to which the Group will or may be exposed. Therefore, ČSOB also assesses and takes into account, under the ICAAP the following:

- the processes of planning, preparing and approving new activities, products or systems;
- other ongoing or anticipated material changes in its risk profile or in the external environment;
- effects of possible divergences from the anticipated developments, including the effects of possible extraordinary circumstances; and
- stress test results;

including the methods of reflecting these when planning and securing internal capital resources. The ICAAP strategic planning horizon is three years.

The amount of capital needed is determined using the economic capital method and addresses the following material risks to which the Group is or may be exposed:

- Credit and counterparty risk, (incl. concentration risk)
- Interest rate in banking book
- Market risk banking book (excl. interest rate)
- Market risk trading book
- Operational risk
- Funding and liquidity risk

A relevant amount of economic capital is allocated directly to these types of risk. Other risks, such as liquidity risk, strategic risk and reputational risk, are covered, under ICAAP processes, by qualitative measures in risk management, organisation of processes, control mechanisms, etc.

The amount of capital needed is calculated for the Group as a separate entity within the KBC group at a probability level of 99.9% for a one year period, taking into account relevant diversification effects. The internally defined capital resources must fully cover the total capital need and, if compliance with this condition was at risk, ČSOB, in cooperation with the KBC group, would take relevant remedial measures (increasing capital resources, reducing risk, etc.).

### **Risk measurement and reporting systems**

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Group also runs worse case scenarios that would arise when extreme events that are unlikely to occur do, in fact, occur.

Monitoring and controlling of risks is primarily performed based on limits established by the Group. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries. In addition, the Group monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all businesses is examined and processed in order to analyse, control and identify risks when they arise. This information is presented and explained to the Board of Directors, the RCOC, and the CRO. The reports include aggregate credit exposure, credit metric forecasts, hold limit exceptions, Value at Risk (VaR), interest rate sensitivities, interest rate gaps, liquidity ratios and risk profile changes. Once a quarter, the Supervisory Board receives a comprehensive risk report designed to provide all information necessary to assess and conclude on the risks of the Group.

A daily report is provided to top management and all other relevant members of the Group on the use of market limits and analysis of VaR in the trading book. A weekly report is provided to top management and all other relevant members on interest rate sensitivities and liquidity in the non-trading book.

### **Risk mitigation**

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group. The effectiveness of hedges is assessed by the Middle Office. The effectiveness of all hedge relationships is monitored by the unit quarterly. In situations of ineffectiveness, a new hedge relationship to mitigate risk on a continuous basis is established.

### **Excessive risk concentration**

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. To prevent and manage excessive risk concentration at both a relationship and industry level, the Group, for selected cases, uses credit risk transfer instruments (e.g. risk sharing participation, risk transfer guarantees, etc).

## **40.2 Credit risk**

Credit risk is the risk of a potential loss expected to arise as a consequence of the non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to a commercial transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay, or to events or measures taken by the political or monetary authorities of a particular country. The latter is also referred to as country risk.

The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations. The Group monitors exposures in relation to these limits. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties. This includes also regular collateral revisions.

Since September 2012, the Group is allowed by both Belgian and Czech banking regulators to use the IRB Advanced approach for the capital calculations of its non-retail (Corporate, non-retail SME, Banks, Non-Banking financial institutions) as well as retail exposures. As a result, credit risk is measured, monitored and managed based on the principles of this approach.



For the non-retail exposure (Corporate, non-retail SME, Banks, Non-Banking financial institutions), counterparty risk (i.e. default risk) is managed based on statistical default prediction models that establish a rating (PD / Probability of Default), LGD (Loss Given Default) and EAD (Exposure at Default).

For the retail exposures, statistical models have been developed for PD, LGD and EAD. Contrary to the non-retail exposure, where risk factors are determined on an individual basis, risk factors are determined in Retail based on risk-homogenous sets of exposure (so-called pools).

The model results are used for the capital calculation and for credit decision purposes too.

The default is defined as a situation where at least one of the following conditions is met:

- (i) it may be assumed that the customer will not fulfil its obligations in a proper and timely manner without the Group seeking to collect its outstanding receivable through credit protection;
- (ii) at least one payment of the principal or interest and fees of any obligation of the customer towards the Group is more than 90 days past the due date.

At ČSOB Group, default status is determined to occur any time a forbearance measure-concession is granted: forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. For more, see the section "Forbearance measures".

### **Non-retail exposure**

#### *Rating system: PD (Probability of Default)*

The Group manages its non-retail credit exposure by establishing counterparty limits that are based on individually assigned internal ratings. These ratings are based on IRB Advanced compliant statistical rating models that take into account financial and non-financial data. The individual PD rating is scaled according to the KBC master scale, which has 12 grades going from PD 1 - the best rating to PD 12, which is the worst.

PD 1 to PD 9 represent the performing exposures.

PD 10 contains: (i) customers where the relevant Group credit decision authority has judged the exposure to be 'unlikely to pay' and none of the obligations are more than 90 days overdue; and (ii) restructured loans. After at least twelve months of performance, the restructured loan may be reclassified to the performing status; and (iii) previously restructured loans already classified as performing less than two years ago which become more than 30 days overdue.

PD 11 represents customers, who have been overdue for 90 days or more, but not subject to bankruptcy proceeds yet.

PD 12 represents customers, which are subject to bankruptcy proceeding or Group credit decision authority has judged the exposure to be 'partly or fully lost' without recourse to credit protection.

PD ratings are used not only for the measurement, monitoring and management of credit risk, but also to determine, among other things, the level at which a credit approval must be obtained, the required collateral and pricing.



The following table sets forth a breakdown of the Group's risk categories, including internal and external ratings, for non-retail exposure, and their comparison to the CNB's risk categories:

PD Scale	ČSOB risk categories for Non-retail exposure				ČSOB and CNB risk categories	CNB risk categories
	PD Rating	S&P's Rating	Performance	Impairment		
Normal	1-7	AAA - B	Performing customers	Collectively assessed	Non-defaulted	Standard
Asset Quality review (AQR)	8-9	(B-) - C	Performing customers	Collectively assessed	Non-defaulted	Watched
Uncertain	10	D	Non-performing customers	Individually impaired	Defaulted	Substandard
Uncertain	11	D	Non-performing customers	Individually impaired	Defaulted	Doubtful
Irrecoverable	12	D	Non-performing customers	Individually impaired	Defaulted	Loss

### Individual Credit Processes

The individual approval, monitoring and work-out processes are subject to risk and capital management frameworks approved by the Group Risk Management (GRM) and/or the CRO but developed, maintained and implemented by the Credit Departments in the Group. These Credit Departments are also responsible for the implementation of these frameworks in the day-to-day operations of the credit processes and for assuring that individual risk acceptance remains within the limits set by the risk appetite statement.

#### Application Process

The loan or credit application process for non-retail credit exposures involves three steps. Firstly, the employee maintaining the overall relationship with the customer prepares a credit application containing the credit request, the reason for the application and an analysis of the risks (including a financial analysis). Secondly, a credit risk advisor operating independently from the business line, who reports to the Credit Department, provides a written non-binding advice. Thirdly, a decision is taken by the Credit Sanctioning Committee (CSC), the highest local decision taking body, or one of its sub-committees consisting of business line employees and employees in the Credit Department. The Committee adopts its decisions by consensus based on a draft decision formulated by the Chairman or Vice - Chairman.

Within the delegation framework set by the Group, the Credit Department can delegate the credit decision to the regional manager or senior relationship manager of a branch. Delegations are granted *ad personam*. The delegations are risk based and take into account the total exposure with respect to a customer or customer group.

All credit decisions must be taken according to the "four eyes principle", i.e. at least two persons need to be involved.

#### Individual Monitoring Process

An individual credit monitoring process is applicable to all non-retail exposures. Credit exposures with a rating between PD 1 – 8 (non-retail SME) / PD 1 – 9 (corporate) are reviewed by the business function with the support of monitoring applications. Credit exposures with a rating between PD 9 – 12 (non-retail SME) / PD 10 – 12 (corporate) are reviewed by the Bad Debt Department, which is a sub-department of the Credit Departments.

Regardless of the PD rating, a full credit application must be submitted to the applicable decision authority for a review at least once a year in accordance with the same application process as for the new exposures. Additionally, certain triggers lead to a more frequent review of credit applications. These triggers include breaches of contractual conditions (such as the breach of financial or non-financial covenants or the non-payment of fees, interest or principal), but also events that do not constitute a breach of contract such as a sudden unexpected change in management that could lead to a deterioration of the customer's financial situation.

In addition to the annual review process, commercial real estate finance, acquisition finance and project finance are subject to a quarterly review by the CSC, pursuant to which all major exposure is subject to a short review of its main credit risk characteristics. Based on the outcome of the general quarterly review, the CSC can take immediate action or request an early full review of the file.

#### *Collective Monitoring Process*

In addition to the required annual review process, a collective monitoring process is applied to non-retail SME customers. The monitoring of compliance by the customer with covenants specified in the relevant financing documentation is based on information provided by the customer in covenant compliance reports and financial statements. A breach of the internal thresholds and covenants specified in the financing documentation triggers the individual review process as described above.

#### *Bad Debts Treatment*

For both corporate and non-retail SME customers, the management of bad debts is the sole responsibility of the Bad Debt Department. The credit customer relationship is transferred to the Bad Debt Department when an exposure reaches a PD rating of 9 in the case of non-retail SME and PD rating of 10, in the case of corporate customers.

### **Retail exposure (Entrepreneurs, retail SMEs and Individuals)**

#### *Risk Categories*

The following table sets forth a breakdown of the Group's risk categories for retail exposure and their comparison to the CNB's risk categories:

PD Scale	ČSOB risk categories for Retail exposure			ČSOB and CNB risk categories	CNB risk categories
	Days overdue	Performance	Impairment		
Normal	0 - 30	Performing	Collectively assessed	Non-defaulted	Standard
Asset Quality review (AQR)	31 - 90	Performing	Collectively assessed	Non-defaulted	Watched
Uncertain	91 - 180	Non-performing	Individually impaired	Defaulted	Substandard
Uncertain	181 - 360	Non-performing	Individually impaired	Defaulted	Doubtful
Irrecoverable	360 and more	Non-performing	Individually impaired	Defaulted	Loss

In addition, all restructured exposures fall initially within the non-performing category irrespective of whether or not they are overdue. After at least twelve months of performance the restructured exposures may be reclassified to the performing status. Previously restructured exposures already classified as performing less than two years ago, can fall again into non-performing category when becoming more than 30 days overdue.

#### *Application Process*

The application process in the retail segment is based on the usage of application scorecards for new customers and behavioural scorecards for existing customers. For consumer finance products (personal unsecured loans, retail overdrafts and credit cards) decisions are fully automated based on scorecards in the vast majority of cases. Mortgage decisions are supported by scorecards but decision-taking is essentially manual.

The application process makes extensive use of several external credit bureau databases that include both positive and negative information.

### *Monitoring Process*

The monitoring process in the retail segment is performed regularly by the relevant Credit Departments and the GRM. It is based on aggregated data. It does not involve individual reviews and looks at the development of defaults and probability of default within different sub-portfolios and development of Credit Cost Ratios within the different sub-portfolios. The development of the mortgage portfolio is monitored also on the basis of pool migration (i.e. migration between different risk pools).

### *Collection Process*

The collection process in retail consumer finance consists of two major phases: early collection and late collection. Early collection is generally based on a rapid succession of reminders (via a call centre or automated written notices) starting when any payment is three days overdue and may involve the restructuring of the loan. Late collection is focused on legal proceedings and the recovery of collateral. In addition, mortgage collection also uses field collection for customers whose payments are less than 180 days overdue and which precedes late collection. Collection units within the Group are monitored by the Risk Function.

### **Derivative financial instruments**

Positive fair values arising from financial derivative instruments entered into by the Group, such as foreign exchange derivatives and interest rate swaps, give rise to potential future claims resulting from counterparty default and are therefore treated for credit risk purposes in the same way as credit exposures.

### **Credit-related commitments risk**

The Group provides guarantees and letters of credit on behalf of its customers, as a result of which the Group may be required to make payments on such customers' behalf. Such payments are subsequently required to be reimbursed to ČSOB by the customer based on the terms of the underlying credit documentation. These guarantees expose the Group to similar risks as loans and such risks are managed using the same credit risks control processes and policies.

The following two main commitment risks are treated as off-balance sheet within the Group:

- (i) *Undrawn but Committed Exposure*. This exposure arises when the Group has a legal commitment to provide a borrower with a facility or credit when asked and such facility or credit has not yet been drawn. This type of exposure comprises to a large extent of short-term exposure, where the Group's commitment has a duration equal to or shorter than one year.
- (ii) *Off-Balance Sheet Products*. This exposure consists of bank guarantees and/or letters of credit. Off-balance sheet products are granted predominantly in the corporate segment and often consist of bid, performance or advance payment bonds for domestic construction companies.

Commitment risks expose the Group to similar risks as loans and such risks are monitored and managed using the same credit risk control processes and policies.

The Group manages credit risk in three major portfolios: Credit portfolio, Investment portfolio and Trading portfolio. Besides these there is a credit exposure connected with settlement activities (correspondent banking, settlement of receivables generated within system of electronic toll, which ČSOB administers for the Czech Government - e-Toll), where the risk is limited as counterparties are either highly rated banks, government institutions or entities with guarantees by highly rated banks.

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2016. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

(CZKm)	Credits	Investment	Trading	Other assets	Total
<b>ASSETS</b>					
Cash and balances with central banks (Note: 15)	-	47,997	-	-	47,997
Financial assets held for trading	-	450	19,558	-	20,008
Financial assets designated at fair value through profit or loss	-	-	-	-	-
Available-for-sale financial assets	2,487	54,451	-	-	56,938
Loans and receivables	540,647	237,674	-	4,902	783,223
Held-to-maturity investments	834	131,845	-	-	132,679
Fair value adjustments of the hedged items in portfolio hedge	-	852	-	-	852
Derivatives used for hedging	-	11,656	-	-	11,656
Other assets (Note: 25)	-	-	-	1,199	1,199
<b>Total</b>	<b>543,968</b>	<b>484,925</b>	<b>19,558</b>	<b>6,101</b>	<b>1,054,552</b>
Contingent liabilities (Note: 35)	31,335	-	-	-	31,335
Commitments – irrevocable (Note: 35)	118,292	-	-	-	118,292
<b>Total</b>	<b>149,627</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>149,627</b>
<b>Total credit risk exposure</b>	<b>693,595</b>	<b>484,925</b>	<b>19,558</b>	<b>6,101</b>	<b>1,204,179</b>

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2015. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

(CZKm)	Credits	Investment	Trading	Other assets	Total
<b>ASSETS</b>					
Cash and balances with central banks (Note: 15)	-	107,765	-	-	107,765
Financial assets held for trading	-	469	29,025	-	29,494
Financial assets designated at fair value through profit or loss	-	15	-	-	15
Available-for-sale financial assets	2,245	57,716	-	-	59,961
Loans and receivables	501,150	73,902	-	4,396	579,448
Held-to-maturity investments	1,333	135,100	-	-	136,433
Fair value adjustments of the hedged items in portfolio hedge	-	957	-	-	957
Derivatives used for hedging	-	11,900	-	-	11,900
Other assets (Note: 25)	-	-	-	1,224	1,224
<b>Total</b>	<b>504,728</b>	<b>387,824</b>	<b>29,025</b>	<b>5,620</b>	<b>927,197</b>
Contingent liabilities (Note: 35)	29,288	-	-	-	29,288
Commitments – irrevocable (Note: 35)	107,224	-	-	-	107,224
<b>Total</b>	<b>136,512</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>136,512</b>
<b>Total credit risk exposure</b>	<b>641,240</b>	<b>387,824</b>	<b>29,025</b>	<b>5,620</b>	<b>1,063,709</b>

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Set out below is an analysis of the maximum exposure to credit risk of the Group before and after taking into account the collateral held:

(CZKm)	2016			2015		
	Gross maximum exposure	Financial effect of collateral	Net maximum exposure	Gross maximum exposure	Financial effect of collateral	Net maximum exposure
<b>ASSETS</b>						
Cash and balances with central banks (Note: 15)	47,997	-	47,997	107,765	-	107,765
Financial assets held for trading	20,008	669	19,339	29,494	478	29,016
Financial assets designated at fair value through profit or loss	-	-	-	15	-	15
Available-for-sale financial assets	56,938	-	56,938	59,961	-	59,961
Loans and receivables	783,223	617,762	165,461	579,448	411,124	168,324
Held-to-maturity investments	132,679	-	132,679	136,433	-	136,433
Fair value adjustments of the hedged items in portfolio hedge	852	-	852	957	-	957
Derivatives used for hedging	11,656	791	10,865	11,900	782	11,118
Other assets (Note: 25)	1,199	-	1,199	1,224	-	1,224
<b>Total</b>	<b>1,054,552</b>	<b>619,222</b>	<b>435,330</b>	<b>927,197</b>	<b>412,384</b>	<b>514,813</b>
Contingent liabilities and Commitments – irrevocable (Note: 35)	149,627	42,532	107,095	136,512	34,234	102,278
<b>Total credit risk exposure</b>	<b>1,204,179</b>	<b>661,754</b>	<b>542,425</b>	<b>1,063,709</b>	<b>446,618</b>	<b>617,091</b>

Financial effect of collateral represents a fair value of collateral received by the Group against a credit exposure limited to the outstanding amount of the exposure.

The credit portfolio is structured according to the type of the business the Group enters into:

<b>2016</b> (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	<b>Granted exposure</b>	Allowances	Provisions	<b>Net exposure</b>
Mortgage loans	256,689	-	21,762	<b>278,451</b>	(2,562)	-	<b>275,889</b>
Consumer loans	24,183	16	9,635	<b>33,834</b>	(1,044)	(17)	<b>32,773</b>
SME	82,271	3,418	29,984	<b>115,673</b>	(3,673)	(118)	<b>111,882</b>
Leasing	36,202	-	1,970	<b>38,172</b>	(538)	-	<b>37,634</b>
Corporate	149,098	27,668	54,296	<b>231,062</b>	(1,851)	(85)	<b>229,126</b>
Factoring	5,563	-	-	<b>5,563</b>	(371)	-	<b>5,192</b>
Other	28	465	645	<b>1,138</b>	(27)	(12)	<b>1,099</b>
<b>Total credits</b>	<b>554,034</b>	<b>31,567</b>	<b>118,292</b>	<b>703,893</b>	<b>(10,066)</b>	<b>(232)</b>	<b>693,595</b>

<b>2015</b> (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	<b>Granted exposure</b>	Allowances	Provisions	<b>Net exposure</b>
Mortgage loans	231,533	-	15,226	<b>246,759</b>	(3,125)	-	<b>243,634</b>
Consumer loans	20,333	10	8,743	<b>29,086</b>	(1,183)	(15)	<b>27,888</b>
SME	81,072	2,951	27,841	<b>111,864</b>	(3,804)	(86)	<b>107,974</b>
Leasing	33,147	-	1,308	<b>34,455</b>	(487)	-	<b>33,968</b>
Corporate	145,051	25,828	53,772	<b>224,651</b>	(1,960)	(69)	<b>222,622</b>
Factoring	4,483	-	-	<b>4,483</b>	(369)	-	<b>4,114</b>
Other	68	784	334	<b>1,186</b>	(31)	(115)	<b>1,040</b>
<b>Total credits</b>	<b>515,687</b>	<b>29,573</b>	<b>107,224</b>	<b>652,484</b>	<b>(10,959)</b>	<b>(285)</b>	<b>641,240</b>

An industry sector analysis of the Group's Credit portfolio, before taking into account any collateral held or other credit enhancements, is as follows:

Sector	2016		2015	
	Granted exposure (CZKm)	Percentage of total exposure	Granted exposure (CZKm)	Percentage of total exposure
Private persons	307,920	43.8	271,608	41.6
Services	63,333	9.0	60,477	9.3
Distribution	57,760	8.2	55,636	8.5
Commercial Real Estate	46,682	6.6	35,302	5.4
Automotive	39,235	5.6	38,198	5.9
Building and Construction	37,153	5.3	33,018	5.1
Oil, Gas and other Fuels	19,922	2.8	20,500	3.1
Machinery and Heavy Equipment	17,163	2.4	16,887	2.6
Electricity	14,897	2.1	15,344	2.4
Metals	13,758	2.0	14,129	2.2
Authorities	13,681	1.9	17,204	2.6
Finance and Insurance	10,800	1.5	12,511	1.9
Other sectors	61,589	8.8	61,670	9.4
<b>Total</b>	<b>703,893</b>	<b>100.0</b>	<b>652,484</b>	<b>100.0</b>

The investment portfolio is structured according to the type of the instrument.

<b>2016</b> (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Cumulative impairment loss	<b>Granted exposure</b>
Debt securities	185,880	-	-	-	<b>185,880</b>
Equity securities	492	-	-	(76)	<b>416</b>
Loans and receivables within investment portfolio	238,526	-	-	-	<b>238,526</b>
Derivatives used for hedging	11,656	-	-	-	<b>11,656</b>
Derivatives held for trading	450	-	-	-	<b>450</b>
Cash and balances with central banks	47,997	-	-	-	<b>47,997</b>
<b>Total investment</b>	<b>485,001</b>	-	-	<b>(76)</b>	<b>484,925</b>

<b>2015</b> (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Cumulative impairment loss	<b>Granted exposure</b>
Debt securities	191,501	-	-	-	<b>191,501</b>
Equity securities	1,433	-	-	(103)	<b>1,330</b>
Loans and receivables within investment portfolio	74,859	-	-	-	<b>74,859</b>
Derivatives used for hedging	11,900	-	-	-	<b>11,900</b>
Derivatives held for trading	469	-	-	-	<b>469</b>
Cash and balances with central banks	107,765	-	-	-	<b>107,765</b>
<b>Total investment</b>	<b>387,927</b>	-	-	<b>(103)</b>	<b>387,824</b>

The investment portfolio is monitored from a counterparty sector point of view:

Sector	2016		2015	
	Granted exposure (CZKm)	Percentage of total exposure	Granted exposure (CZKm)	Percentage of total exposure
Central banks	283,000	58.3	177,766	45.9
General government	169,094	34.9	171,755	44.3
Credit institutions	32,380	6.7	36,607	9.4
Corporate	451	0.1	1,696	0.4
<b>Total investment</b>	<b>484,925</b>	<b>100.0</b>	<b>387,824</b>	<b>100.0</b>



The trading portfolio is structured according to the type of the instrument.

<b>2016</b> (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	<b>Granted exposure</b>
Debt securities	7,220	-	-	<b>7,220</b>
Equity securities	1	-	-	<b>1</b>
Loans and advances	170	-	-	170
Derivatives held for trading	12,167	-	-	<b>12,167</b>
<b>Total trading portfolio</b>	<b>19,558</b>	-	-	<b>19,558</b>

<b>2015</b> (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	<b>Granted exposure</b>
Debt securities	18,084	-	-	<b>18,084</b>
Equity securities	6	-	-	<b>6</b>
Derivatives held for trading	10,935	-	-	<b>10,935</b>
<b>Total trading portfolio</b>	<b>29,025</b>	-	-	<b>29,025</b>

The trading portfolio is monitored from a counterparty sector point of view:

Sector	2016		2015	
	Granted exposure (CZKm)	Percentage of total exposure	Granted exposure (CZKm)	Percentage of total exposure
General government	4,527	23.2	13,270	45.7
Credit institutions	10,431	53.3	10,744	37.0
Corporate	4,600	23.5	5,011	17.3
<b>Total trading portfolio</b>	<b>19,558</b>	<b>100.0</b>	<b>29,025</b>	<b>100.0</b>

### Risk concentrations of the maximum exposure to credit risk

The concentration of risk is managed by geographical region, industry and by client/counterparty. The Group's financial assets, before taking into account any collateral held or other credit enhancements can be analysed by the following geographical regions:

(CZKm)	2016		2015	
	Total risk	of which General government	Total risk	of which General government
Czech Republic	1,118,156	160,464	980,653	174,675
Slovak Republic	20,595	8,041	15,353	7,441
Belgium	14,392	1,835	14,151	2,438
Italy	2,798	-	5,016	-
Hungary	630	-	658	-
Spain	125	-	288	-
Greece	15	-	1	-
Other Europe	42,128	10,661	44,235	10,371
Other	5,340	-	3,354	-
<b>Total</b>	<b>1,204,179</b>	<b>181,001</b>	<b>1,063,709</b>	<b>194,925</b>

Client concentration is monitored on the level of individual portfolios. In the credit portfolio the exposure towards groups of economically connected subjects are monitored:

Client	2016		2015	
	Granted exposure (CZKm)	Percentage of total exposure	Granted exposure (CZKm)	Percentage of total exposure
1 largest client	8,411	1.2	8,272	1.3
10 largest clients	55,882	7.9	53,514	8.2
25 largest clients	98,604	14.0	94,032	14.4

The largest exposures to single clients in the investment and trading portfolio as at 31 December 2016 and 31 December 2015 were:

Client	2016		2015	
	Granted exposure (CZK m)	% of total investment portfolio	Granted exposure (CZK m)	% of total investment portfolio
<b>Investment portfolio</b>				
Czech Ministry of Finance (S&P's Rating AA)	148,558	30.6	151,528	39.1
CNB	283,000	58.4	177,766	45.9
<b>Trading portfolio</b>				
Czech Ministry of Finance (S&P's Rating AA)	4,527	23.1	13,269	45.7
KBC Bank	2,892	14.8	2,685	9.3

#### Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For securities lending and reverse repurchase transactions, cash or securities;
- For commercial lending, pledges over real estate properties, trade receivables and inventory;
- For retail lending, pledges over residential properties are used for mortgage financing.

The Group continuously monitors the market value of all collateral, monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses and requests additional collateral in accordance with the underlying agreement when necessary. The amount of collateral reported for an individual receivable does not exceed the carrying amount of the receivable.

Within concluding derivatives transaction to hedge counterparty's risk the Group uses Master netting agreements and collateralisation annex (i.e. CSA or its equivalents).

## Impairment assessment

The main considerations for credit impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, worsening of their credibility reflected by credit rating downgrades or infringement of the original terms of the contract. The Group addresses impairment in two areas: specific impairments and impairments incurred but not reported (IBNR).

Specific impairments are applied to individual assets where there is registered objective evidence of default. All defaulted exposure requires an impairment test – when a client becomes defaulted, it is considered to be impaired and thus specific impairment has to be accounted for. IBNR are applied for asset groups that based on statistical evidence contain probably already impaired assets, but have not been yet individually recognised.

### *Specific impairment (Individual assessment)*

The Group determines allowances appropriate for loans with outstanding amounts above a predefined materiality threshold where there is registered objective evidence of default on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of other financial support, liquidation value of collateral, and the timing of the expected cash flows. Impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention. For insignificant exposures with registered objective evidence of default, a portfolio approach for deriving the impairment allowance is applied using statistical methods and models.

### *IBNR (Collective assessment)*

Collective allowances are applied for loans and advances where there has not yet been recognised objective evidence of impairment and they reflect impairment that is likely to be present in the group of assets. Collective allowances are assessed based on statistical estimates and evaluated at each reporting period.

Collective allowances are estimated by taking into consideration:

- (i) historical losses in the portfolio;
- (ii) current economic conditions;
- (iii) the approximate delay between the time a loss is likely to have been incurred and the time it will be identified (emergence period).

The local management is responsible for deciding on the length of the emergence period. In 2014, the Group used a uniform emergence period of four months, which was confirmed by the back-testing. In 2015, the emergence period has been extended to 6 – 8 months for some of the segments based on the latest back-testing results and in 2016 further changes have been made for other segments, prolonging the emergence period also to 8 months. The emergence period extension resulted in 2016 and 2015 an increase of the collective impairment provision of CZK 160 m (2015: CZK 390 m). The back-testing methodology was refined in 2016 and 2015 following the updated Group policy on determining the emergence period and its back-testing.

Financial guarantees and letters of credit are assessed and provisions are made for them in a similar manner as allowances for loans and other receivables.

## Quality of credit portfolio

The Group sorts exposures into five categories for the purpose of credit risk management. The table below shows the credit quality by class of asset for loan-related statement of financial position lines (in gross amounts), based on the Group's credit rating system as at 31 December 2016 and 2015 by individual portfolios:

### Credit portfolio

(CZK <sup>m</sup> )	2016					Total
	Collectively assessed assets		Individually impaired assets			
	Normal	AQR	Uncertain (Substandard)	Uncertain (Doubtful)	Irrecoverable	
Mortgage loans	248,637	2,106	1,145	464	4,337	256,689
Consumer loans	22,994	141	62	201	785	24,183
SME	75,526	2,112	1,416	338	2,879	82,271
Leasing	34,812	723	-	241	426	36,202
Corporate	141,421	4,240	1,892	-	1,545	149,098
Factoring	4,764	-	646	-	153	5,563
Other	3	-	-	1	24	28
<b>Total</b>	<b>528,157</b>	<b>9,322</b>	<b>5,161</b>	<b>1,245</b>	<b>10,149</b>	<b>554,034</b>

(CZK <sup>m</sup> )	2015					Total
	Collectively assessed assets		Individually impaired assets			
	Normal	AQR	Uncertain (Substandard)	Uncertain (Doubtful)	Irrecoverable	
Mortgage loans	221,738	2,593	1,237	561	5,404	231,533
Consumer loans	18,902	158	176	220	877	20,333
SME	73,904	2,066	1,476	371	3,255	81,072
Leasing	32,015	557	-	212	363	33,147
Corporate	138,574	2,673	1,936	221	1,647	145,051
Factoring	3,707	-	651	-	125	4,483
Other	36	-	3	-	29	68
<b>Total</b>	<b>488,876</b>	<b>8,047</b>	<b>5,479</b>	<b>1,585</b>	<b>11,700</b>	<b>515,687</b>

**Investment portfolio**

(CZKm)	2016		
	Collectively assessed assets	Individually impaired assets	Total
	Normal	Irrecoverable	
Debt securities	185,880	-	185,880
Equity securities	391	25	416
Loans and receivables within investment portfolio	238,526	-	238,526
Derivatives used for hedging	11,656	-	11,656
Derivative contracts held for trading	450	-	450
Cash and balances with central banks	47,997	-	47,997
<b>Total</b>	<b>484,900</b>	<b>25</b>	<b>484,925</b>

(CZKm)	2015		
	Collectively assessed assets	Individually impaired assets	Total
	Normal	Irrecoverable	
Debt securities	191,501	-	191,501
Equity securities	1,303	27	1,330
Loans and receivables within investment portfolio	74,859	-	74,859
Derivatives used for hedging	11,900	-	11,900
Derivative contracts held for trading	469	-	469
Cash and balances with central banks	107,765	-	107,765
<b>Total</b>	<b>387,797</b>	<b>27</b>	<b>387,824</b>

**Trading portfolio**

(CZKm)	2016		
	Collectively assessed assets	Individually impaired assets	Total
	Normal	Irrecoverable	
Debt securities	7,220	-	7,220
Equity securities	1	-	1
Loans and advances	170	-	170
Derivative contracts held for trading	12,167	-	12,167
<b>Total</b>	<b>19,558</b>	<b>-</b>	<b>19,558</b>

(CZKm)	2015		
	Collectively assessed assets	Individually impaired assets	Total
	Normal	Irrecoverable	
Debt securities	18,084	-	18,084
Equity securities	6	-	6
Derivative contracts held for trading	10,935	-	10,935
<b>Total</b>	<b>29,025</b>	<b>-</b>	<b>29,025</b>

The table below shows a credit quality analysis of gross exposures of collectively assessed financial assets in the Credit portfolio:

(CZKm)	2016			2015		
	Neither past due nor individually impaired	Past due (< 30 days) but not individually impaired	Past due (> 30 days) but not individually impaired	Neither past due nor individually impaired	Past due (< 30 days) but not individually impaired	Past due (> 30 days) but not individually impaired
Mortgage loans	242,212	7,020	1,511	214,450	7,971	1,910
Consumer loans	22,549	504	82	18,606	379	75
SME	76,613	956	69	75,582	325	63
Leasing	35,393	132	10	32,492	55	25
Corporate	145,661	-	-	141,247	-	-
Factoring	4,764	-	-	3,707	-	-
Other	3	-	-	36	-	-
<b>Total</b>	<b>527,195</b>	<b>8,612</b>	<b>1,672</b>	<b>486,120</b>	<b>8,730</b>	<b>2,073</b>

Collectively assessed assets reported within Neither past due nor individually impaired gross exposures consist of Normal risk category assets based on the Group's credit rating system.

There were no past due but not impaired assets in the Investment and Trading portfolios.

Gross amounts of individually impaired financial assets included in the credit portfolio and the related impairment are as follows:

(CZKm)	2016		2015	
	Gross amount	Impairment	Gross amount	Impairment
Mortgage loans	5,946	(2,307)	7,202	(2,795)
Consumer loans	1,048	(798)	1,273	(963)
SME	4,633	(3,336)	5,102	(3,605)
Leasing	667	(427)	575	(350)
Corporate	3,437	(1,767)	3,804	(1,887)
Factoring	799	(350)	776	(353)
Other	25	(25)	32	(31)
<b>Total</b>	<b>16,555</b>	<b>(9,010)</b>	<b>18,764</b>	<b>(9,984)</b>

Individually impaired financial assets included in the investment portfolio in the carrying amounts are as follows:

(CZKm)	2016	2015
Equity securities	25	27
<b>Total</b>	<b>25</b>	<b>27</b>

### Forbearance measures

Based on the new guidelines on non-performing exposures and forbearance measures laid down by the European Banking Authority, which came into effect on 30 September 2014, the Group implemented a new definition of forborne loans in 2014.

Forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. Contracts for which forbearance measures have been taken and for which the exit criteria are not fulfilled are referred to as "Forborne credits". Such an approach enables the Group to control and limit potential future losses stemming from troubled credits.

As a result of the update of the Definition of Default made by the Group, the Group's definition of default is now aligned with the EBA definition of non-performing exposures (PD 10-11-12), meaning that from 2014 they are only to be seen as synonyms. Previously, only PD grades 11 and 12 fell

within the 'non-performing' exposure category. The same holds for the definition of the individually impaired financial instrument according to IFRS.

The approved changes impacted the business of the Group in the following way. The minimum period for the default status for the forbore exposures has been extended from 6 to 12 months; following the conservative approach of the local regulator, default status occurs any time a forbearance measure-concession is granted. The minimum period for assignment of the 'Forborne tag' is therefore 36 months: this period consists of the 12 months of the default status, and 24 months of what is referred to as the 'probation period'. In addition, any time more than 30 days past due are observed at an individual receivable during the 'probation period', the receivable is re-classified as defaulted and the 36-month period is re-set.

The implementation of changes in 2014 in the Group increased the balance of non-performing exposures by CZK 741 m, and led to the creation of an additional individual impairment of CZK 110 m.

Outstanding gross amounts and gross amounts of forbore exposures included in the credit portfolio and the related impairment and collateral and financial guarantees as at 31 December 2016 and 2015 are as follows:

(CZKm)	2016				
	Outstanding gross amount	Forborne exposures			
		Exposure of collectively and individually assessed assets	Percentage of outstanding gross amount (%)	Individual and collective impairment	Collateral and financial guarantees
Corporate	162,312	2,766	1.7	755	1,219
SME	93,754	1,295	1.4	647	404
Mortgage loans	256,689	2,323	0.9	293	2,031
Other	41,279	429	1.0	109	105
<b>Total</b>	<b>554,034</b>	<b>6,813</b>	<b>1.2</b>	<b>1,804</b>	<b>3,759</b>

(CZKm)	2015				
	Outstanding gross amount	Forborne exposures			
		Exposure of collectively and individually assessed assets	Percentage of outstanding gross amount (%)	Individual and collective impairment	Collateral and financial guarantees
Corporate	157,574	2,778	1.8	737	1,912
SME	92,090	1,345	1.5	593	478
Mortgage loans	231,532	2,508	1.1	321	2,416
Other	34,491	423	1.2	117	86
<b>Total</b>	<b>515,687</b>	<b>7,054</b>	<b>1.4</b>	<b>1,768</b>	<b>4,892</b>

Detail analysis of forbore exposures included in the credit portfolio and the related impairment as at 31 December 2016 and 2015 are as follows:

(CZKm)	2016				
	Exposure of collectively assessed assets	Of which past due but not individually impaired assets	Exposure of individually impaired assets	Individual impairment	Collective impairment
Corporate	743	4	2,022	755	-
SME	229	28	1,066	642	5
Mortgage loans	889	148	1,435	229	64
Other	158	26	271	106	3
<b>Total</b>	<b>2,019</b>	<b>206</b>	<b>4,794</b>	<b>1,732</b>	<b>72</b>



## 2015

(CZKm)	Exposure of collectively assessed assets	Of which past due but not individually impaired assets	Exposure of individually impaired assets	Individual impairment	Collective impairment
Corporate	741	-	2,037	734	3
SME	196	1	1,149	591	2
Mortgage loans	1,009	160	1,499	244	77
Other	171	9	252	114	3
<b>Total</b>	<b>2,117</b>	<b>170</b>	<b>4,937</b>	<b>1,683</b>	<b>85</b>

The following table shows a reconciliation of Gross amounts of forborne exposures for 2016 and 2015 by classes of financial instruments:

(CZKm)	Corporate	SME	Mortgage loans	Other	Total
<b>At 1 January 2015</b>	<b>2,975</b>	<b>1,241</b>	<b>2,137</b>	<b>272</b>	<b>6,625</b>
Loans which have become forborne	48	478	889	230	1,645
Loans which are no longer considered to be forborne	(136)	(13)	(120)	-	(269)
Increase of exposure	24	8	-	1	33
Decrease of exposure	(161)	(369)	(403)	(80)	(1,013)
Other movements	28	-	5	-	33
<b>At 31 December 2015</b>	<b>2,778</b>	<b>1,345</b>	<b>2,508</b>	<b>423</b>	<b>7,054</b>
Loans which have become forborne	1,882	350	647	168	3,047
Loans which are no longer considered to be forborne	(1,851)	(237)	(368)	(88)	(2,544)
Increase of exposure	49	13	-	-	62
Decrease of exposure	(92)	(176)	(469)	(74)	(811)
Other movements	-	-	5	-	5
<b>At 31 December 2016</b>	<b>2,766</b>	<b>1,295</b>	<b>2,323</b>	<b>429</b>	<b>6,813</b>

The following table shows a reconciliation of Impairments of forborne exposure for 2016 and 2015 by classes of financial instruments:

(CZKm)	Corporate	SME	Mortgage loans	Other	Total
<b>At 1 January 2015</b>	<b>754</b>	<b>453</b>	<b>242</b>	<b>88</b>	<b>1,537</b>
Loans which have become forborne	11	239	172	63	485
Loans which are no longer considered to be forborne	(13)	(9)	(2)	-	(24)
Increase of exposure	2	82	-	10	94
Decrease of exposure	(24)	(172)	(91)	(44)	(331)
Other movements	7	-	-	-	7
<b>At 31 December 2015</b>	<b>737</b>	<b>593</b>	<b>321</b>	<b>117</b>	<b>1,768</b>
Loans which have become forborne	61	148	74	41	324
Loans which are no longer considered to be forborne	(92)	(73)	(19)	(22)	(206)
Increase of exposure	63	92	-	12	167
Decrease of exposure	(14)	(113)	(83)	(39)	(249)
<b>At 31 December 2016</b>	<b>755</b>	<b>647</b>	<b>293</b>	<b>109</b>	<b>1,804</b>

### 40.3 Liquidity risk and funding management

Liquidity risk is the risk that the Group will not be able to efficiently meet both expected and unexpected current and future cash flows and collateral needs without normal business operations being disrupted. To limit this risk, the Group pays significant attention to both operational and strategic liquidity management.

#### Operational Liquidity Management

The aim of operational liquidity management is to ensure the smooth processing of the Group's current payment obligations in CZK as well as in other currencies while minimizing associated cost. Operational liquidity is based on cash flow projections with an outlook of up to ten working days for CZK and one day for other currencies.

#### Funding Management

The actual development of liquidity might vary from ALM's liquidity prediction. The Group can address an adverse liquidity development in several ways. Most typically, the Group would adjust its investment policy, i.e. decrease the percentage of liabilities reinvested in cash form and use the liquidity from maturing bonds for other purposes. In the event of a more sudden decrease of liquidity, the Group can borrow via repo operations on the market or use regulatory repo facilities (in the CNB or ECB). The capacity and readiness to withstand adverse liquidity development is regularly reviewed by the means of stress tests.

Starting from October 2015, the Group reports on Liquidity Coverage Ratio (LCR), which compares available liquidity buffers to expected net cash outflows within the 30 day horizon under gravely stressed conditions.

The LCR during 2016 and 2015 was as follows:

(%)	2016	2015
31 March	161.6	n/a
30 June	156.2	n/a
30 September	161.3	n/a
31 December	155.7	163.4

The LCR ratio is regularly monitored and reported to the top management of the Group.

#### Strategic Liquidity Management

The aim of strategic liquidity management is to provide sufficient funding for the Group's business activities in the medium- and long-term horizon. For strategic liquidity management, the Group uses the net-stable-funding-ratio (NSFR) which is defined as a ratio of available stable funding (numerator) to required stable funding (denominator). The strategy of the Group is to maintain the value of the NSFR well above one. That means the Group aims to maintain matched funding, i.e. to ensure that long-term assets are funded by stable liabilities (contractually or statistically), while short-term liabilities are used for the funding of assets that are short-term and/or liquid.

The NSFR is monitored on a monthly basis and it is regularly reported to the top management of the Group.

The NSFR during 2016 and 2015 was as follows:

(%)	2016	2015
31 March	149.0	136.5
30 June	145.9	134.0
30 September	149.5	131.6
31 December	150.9	134.9

In addition to internally defined limits, the Group must also comply with a regulatory limit on the basis of minimum statutory reserves deposited with ČNB. The limit presently equals to 2% of customer deposits.

### Analysis of financial liabilities by remaining contractual maturity

The tables below summarise the contractual maturity profile of the Group's financial liabilities based on the contractual undiscounted repayment obligations.

The following table sets out the financial liabilities of the Group by remaining contractual maturity as at 31 December 2016:

(CZKm)	On demand	Less than 1 year	1 year to 5 years	More than 5 years	Total
<b>Financial liabilities</b>					
Financial liabilities held for trading					
Financial derivatives	-	3,568	6,366	2,113	<b>12,047</b>
Other than financial derivatives	-	18,744	6,522	2,278	<b>27,544</b>
Financial liabilities designated at fair value through profit or loss	-	57	1,212	308	<b>1,577</b>
Financial liabilities at amortised cost	657,638	241,035	26,561	6,171	<b>931,405</b>
Fair value adjustments of the hedged items in portfolio hedge	4,796	-	-	-	<b>4,796</b>
Derivatives used for hedging	-	2,764	5,477	2,118	<b>10,359</b>
Other liabilities (Note: 28)	-	4,684	-	-	<b>4,684</b>
<b>Total carrying value</b>	<b>662,434</b>	<b>270,852</b>	<b>46,138</b>	<b>12,988</b>	<b>992,412</b>

The following table sets out the financial liabilities of the Group by remaining contractual maturity as at 31 December 2015:

(CZKm)	On demand	Less than 1 year	1 year to 5 years	More than 5 years	Total
<b>Financial liabilities</b>					
Financial liabilities held for trading					
Financial derivatives	-	4,144	5,862	2,122	<b>12,128</b>
Other than financial derivatives	-	11,753	3,652	2,388	<b>17,793</b>
Financial liabilities at amortised cost	605,202	173,166	27,790	6,687	<b>812,845</b>
Fair value adjustments of the hedged items in portfolio hedge	4,062	-	-	-	<b>4,062</b>
Derivatives used for hedging	-	2,685	5,641	2,406	<b>10,732</b>
Other liabilities (Note: 28)	-	5,467	-	-	<b>5,467</b>
<b>Total carrying value</b>	<b>609,264</b>	<b>197,215</b>	<b>42,945</b>	<b>13,603</b>	<b>863,027</b>

The maturity of contingent liabilities and commitments of CZK 194,591 m (2015: CZK 178,660 m) is less than one year. This represents the undiscounted cash flows of the Group's contingent liabilities and commitments on the basis of their earliest possible contractual maturity. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

The liquidity risk of the Group is not managed based on the remaining contractual maturities of the financial instruments, as such the Group's expected cash flows on these instruments vary significantly from this analysis (Note: 34). For example, undrawn loan commitments are not expected to be drawn down immediately.

## 40.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices. The Group classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored based on a historic VaR methodology that reflects the interdependency between risk variables. The secondary measure for risk management is Basis Point Value (BPV) sensitivity. Non-trading positions are managed and monitored using BPV sensitivity analysis.

### Market risk – Trading

The Board of Directors has set limits on the level of risk that may be accepted. The Group applies a VaR methodology to assess the market risk positions held and to estimate the potential economic loss based upon assumptions for various changes in market conditions. VaR is a method used to measure financial risk by estimating a potential negative change in the market value of a portfolio at a given confidence level and over a specified time horizon. The Group uses a full linear VaR model for interest rate and foreign exchange rate risk. These calculations are based on historic scenarios derived from a two-year history. The Group has no net position in FX options, nor any position in equity. A nominal technical limit for reminder products, in particular interest rate options; commodity derivatives and structured bonds. Positions in these products are not allowed to be material as back-to-back approach is required.

Standard VaR calculations are supplemented by a sophisticated system of stress tests. They consist of examples of extreme, but plausible events on the financial markets to test their impact on the market value of positions currently held by the Group. The Group analyses scenarios, dependent and independent of the Group's position. Also, real historical scenarios are evaluated on a regular basis.

To enhance the system of risk management, the Group also uses other methods of risk monitoring, such as interest rate sensitivity BPV, and stop-loss limits.

#### *Objectives and limitations of the VaR methodology*

The Group uses the historical VaR methodology to measure and monitor interest rate and foreign exchange rate risks in the trading book observing the relevant Basel II standards. The accuracy of estimated results is verified through back-testing.

#### *VaR assumptions*

When measuring risks, the Group applies VaR assumptions to estimate potential losses at a 99% confidence level that is not expected to be exceeded if the current market risk positions were to be held unchanged for 10 days. The use of a 99% confidence level means that, within a ten-day horizon, losses exceeding the VaR figure should occur, on average, not more than once every 100 days. The Group uses historical daily changes in market variables to assess possible changes in the market value of the trading portfolio based on historical data from the past 500 days.

Since VaR is an integral part of the Group's market risk management, VaR limits have been established for all trading operations and exposures are reviewed daily against the limits by the management.

The VaR model is back tested on a daily basis. Daily VaR (1 day holding period) is compared with theoretic profit or loss from holding previous day position. Daily VaR is also compared with the actual profit or loss made by the trading book.

The Group holds regulatory approval to use an internal VaR model for the calculation of capital requirements for interest rate and foreign exchange risks.

The Group calculate a Stress VaR to fulfil CRR/CRD IV requirements for market risk capital. A one year historic stress period is used for determining of stress scenarios. These in combination with antithetic scenarios for the same periods are used for computation of stress VaR. All other assumptions are identical to the standard VaR measurement.

The tables below show potential gains / (losses) analysed using VaR 10D 99% model in 2016 and 2015:

(CZKm)	Interest rate	Foreign exchange	Effect of correlation	Global VaR total
31 December 2016	148	5	(4)	149
Average during the period	168	16	(15)	169
Highest	227	52	(53)	226
Lowest	119	2	1	122

(CZKm)	Interest rate	Foreign exchange	Effect of correlation	Global VaR total
31 December 2015	151	20	(16)	155
Average during the period	127	12	(10)	129
Highest	178	54	(55)	177
Lowest	98	3	(3)	98

## Market risk – Investment portfolio

### *Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board of Directors has established limits on the BPV sensitivity. The Board of Directors has set secondary limits on interest rate gaps for stipulated periods. Positions are monitored on a weekly basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following tables demonstrate the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's statement of income and equity.

The sensitivity of the statement of income is calculated by revaluing financial assets designated at fair value through profit or loss for the effects of the assumed changes in interest rates. The sensitivity of the statement of income is analysed by the maturity of the asset. The total sensitivity of the statement of income is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The sensitivity of equity is calculated by revaluing Available-for-sale financial assets, including the effect of any associated hedges, and swaps designated as cash-flow hedges, for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by the maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The Group's investment portfolio consists of predominantly linear interest rate sensitive products.

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) due to revaluation of assets and liabilities that are measured at fair value on recurring basis as at 31 December 2016:

(CZKm)	Change in basis points	Sensitivity of other comprehensive income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	1.9	(6.1)	(124.1)	(109.7)	(238.0)
EUR	+ 10	-	0.3	31.9	(82.1)	(49.9)
USD	+ 10	-	(0.2)	(4.4)	(39.5)	(44.1)
CZK	- 10	(1.9)	6.1	124.1	109.7	238.0
EUR	- 10	-	(0.3)	(31.9)	82.1	49.9
USD	- 10	-	0.2	4.4	39.5	44.1

(CZKm)	Change in basis points	Sensitivity of the statement of income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	(15.3)	2.6	64.2	24.4	75.9
EUR	+ 10	0.7	0.5	1.6	-	2.8
USD	+ 10	-	-	(2.1)	-	(2.1)
CZK	- 10	15.3	(2.6)	(64.2)	(24.4)	(75.9)
EUR	- 10	(0.7)	(0.5)	(1.6)	0.0	(2.8)
USD	- 10	-	-	2.1	0.0	2.1

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) due to revaluation of assets and liabilities that are measured at fair value on recurring basis as at 31 December 2015:

(CZKm)	Change in basis points	Sensitivity of other comprehensive income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	0.5	2.1	(63.7)	(150.0)	(211.1)
EUR	+ 10	(0.3)	0.3	51.7	25.2	76.9
USD	+ 10	(0.1)	(0.4)	(7.5)	(43.8)	(51.8)
CZK	- 10	(0.5)	(2.1)	63.7	150.0	211.1
EUR	- 10	0.3	(0.3)	(51.7)	(25.2)	(76.9)
USD	- 10	0.1	0.4	7.5	43.8	51.8

(CZKm)	Change in basis points	Sensitivity of the statement of income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	(18.0)	1.9	(28.8)	(83.5)	(128.4)
EUR	+ 10	(0.5)	0.4	(16.6)	39.7	23.0
USD	+ 10	(1.1)	0.1	0.1	33.0	32.1
CZK	- 10	18.0	(1.9)	28.8	83.5	128.4
EUR	- 10	0.5	(0.4)	16.6	(39.7)	(23.0)
USD	- 10	1.1	(0.1)	(0.1)	(33.0)	(32.1)

### Currency risk

Currency risk is the risk that the value of a financial instrument would fluctuate due to changes in foreign exchange rates. The Group adopted a strategy under which the banking book has no open positions in foreign currencies. Positions are monitored on a daily basis and hedging strategies are used to close such positions. Minimum technical residual open positions in foreign currencies are allowed; the Group sets limits for these positions. The technical currency position is added to the currency position of the trading book position and reported in aggregate.

The table below shows the foreign currency risk sensitivity of the statement of income (before tax) as at 31 December 2016 and 2015:

	2016			2015		
	Net position in foreign currency (CZKm)	Increase of foreign exchange rate by 1 CZK/EUR	Decrease of foreign exchange rate by 1 CZK/EUR	Net position in foreign currency	Increase of foreign exchange rate by 1 CZK/EUR	Decrease of foreign exchange rate by 1 CZK/EUR
EUR	7	-	-	(13)	-	-

Sensitivity of the statement of income to currencies other than EUR is not significant.

### Equity price risk

Equity price risk is the risk that the fair values of equities will decrease as a result of changes in the levels of equity indices and in the value of individual stocks. Investment equity price risk exposure arises from the Group's investment portfolio.

- If, at the end of the accounting period, a share is quoted at less than 70% of its acquisition value or;
- If, during a period of one year before the end of the accounting period, the share price of a share was permanently lower than its acquisition value;

The share is irrevocably impaired to the closing quotation at end of the accounting period.

The effect on equity (as a result of a change in the fair value of equity instruments included in Available-for-sale financial assets at 31 December 2016) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, is as follows:

(CZKm)	Change in equity price (%)	Effect on equity
VISA Inc. quotation	- 10	(29)
	+ 10	29

The effect on equity (as a result of a change in the fair value of equity instruments included in Available-for-sale financial assets at 31 December 2015) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, was as follows:

(CZKm)	Change in equity price (%)	Effect on equity
VISA Inc. quotation	- 10	(35)
	+ 10	35

### Prepayment risk

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

Prepayment risk is regularly monitored and assessed in the Group. Convenient tools for prepayment risk limitation are applied in the area of mortgage loans particularly.



## 40.5 Operational risk

The Group defines operational risk in line with Basel III as the risk of loss resulting from inadequate or failed internal procedures, people and systems, or from external events. Operational risks include legal, compliance and tax risks. The impact of incidents on the Group's reputation is taken into consideration when assessing the Group's vulnerability in respect of operational risk incidents.

### Principles of Operational Risk Management

Operational risk management starts with the identification of operational risks having materialized within the Group, as well as an assessment of the Group's vulnerability in respect of potential risks that have not materialised yet. Operational risk management focuses primarily on the key risks and the most risky areas for potential losses. The assessment involves ranking the risks and risk events in terms of their severity and anticipated frequency. The assessment is followed by the decision of an accountable manager, i.e. acceptance of risk or its mitigation by implementing appropriate control measures and/or risk transferring to the 3<sup>rd</sup> parties and/or risk insurance. Risk events that cannot be prevented may be also mitigated by business continuity arrangements.

### Operational Risk Management Governance

The basic objective is to make operational risk management a natural part of the decision-making in business units. Operational risk management governance is promoted by the CRO and the Risk Function. Regular meetings focusing on operational risk management take place at ČSOB subsidiaries and at distribution entities and departments responsible for creating new products within the Group.

#### *Non-financial Risk Management Department (NFRD)*

The NFRD is responsible for reporting in the non-financial risk management area, including operational risk management. This includes coordination, implementation of methodology, assurance of independent control, advisory to business units and training. NFRD covers also business continuity and information security areas. Other risks related to operational risk are coordinated by special units, including the Compliance Unit, Communication Unit, Legal Unit and Tax Unit.

#### *Local Operational Risk Managers (the "LORMs")*

LORMs are first line support for business managers in respect of operational risks. LORMs also act as business continuity coordinators, compliance coordinators and information risk coordinators. Beside frequent contacts, regular meetings of LORMs are organised by the NFRD every quarter for training and exchange of information.

#### *Crisis Management*

Apart from the regular operational risk management infrastructure, the Group has also established a crisis management infrastructure. Major incidents within the Group are resolved by the Crisis Committee with the involvement of the Board of Director members. Additionally, the Group has in place a procedure for resolving local incidents. This procedure is used for more explicit and structured situations, i.e. not complex crises.

### Building Blocks of Operational Risk Management

#### *Loss Data Collection*

Loss events are registered into a loss database, which contains a full description of cases involving a higher level of loss. The quality of loss data is monitored on a daily basis, and data is reconciled regularly.

#### *Detailed Risk Scan*

The Detailed Risk Scan aims to identify and quantify operational risks in products, activities, processes and systems. This activity is forward-looking and allows future developments, e.g. an improvement in the control framework, to be taken into account. It consists of workshops organised and facilitated by the LORM, where business representatives and control function representatives discuss operational risks faced in order to reach a consensus on the adequate risk response (risk acceptance or mitigation).

### *Risk Scan*

Every year, before the risk appetite statement is defined, the Group executes a risk scan identifying and assessing its top risks. All material risk types are explicitly considered, but it is not necessary that a top risk is ultimately withheld for every risk type. The Risk Scan is executed and reported based on the KBC Group Risk Scan Guidance.

The prime responsibility for the identification and assessment of the top risks lies with the business. Input for the risk scan can be derived from several sources, including the main risks identified in the Internal Control Statement, audit recommendations, existing claims, economic forecasts and so on. The Risk Function facilitates the process. This may include gathering business input and documenting the conclusions of the risk scan. The business may call upon the Risk Function for assistance with the identification and assessment of the top risks as well. In any case, the Risk Function challenges the assessment details.

The results of the risk scan, as well as the risk response thereto (acceptance, non-acceptance, mitigating actions), can lead to changes to the existing business plans. Furthermore, they are used as input for the definition of risk appetite in the strategic planning process.

### *Group Key Controls and Zero Tolerances (GKC/ZT)*

The Group Key Controls and Zero Tolerances are top down basic control objectives used to mitigate key & killer non-financial risks (including risks to reputation) that are inherent to the processes of the business entities. Each GKC contain the key & killer operational risks related to the involved business process.

### *Key Risk Indicators*

Key risk indicators are measurable metrics or indicators used to track the exposure to loss or other difficulties. Key risk indicators are used for informing the management of the current level of risk exposure and/or the effectiveness of the controls in place.

## **41. CAPITAL**

### **Capital Adequacy**

Capital adequacy measures the financial strength and stability of an institution. It compares the amount of the capital held by a financial institution to the risk of possible decline in value of assets on its statement of financial position.

Capital adequacy (or solvency) risk is the risk that the capital base of the Group might fall below an acceptable level. In practice, this entails checking solvency against the minimum regulatory and in-house solvency ratios and its active steering.

### **Capital targets and structure**

Regarding the capital targets and structure, the Group fully follows the KBC Group Capital Policy stating that fully owned subsidiaries shall: (i) hold the regulatory minimum capital (all capital in excess of the regulatory minimum must be held at the Group level), and (ii) build up the regulatory capital from equity.

For the purpose of the ICAAP process, available capital of the Pillar II in the Group coincides with the Common equity Tier 1 capital under Pillar I.

### **Managing solvency**

The Group reports its solvency calculated on the basis of IFRS balances, taking into account all relevant regulatory requirements. Solvency targets based on external regulatory capital requirements were met throughout 2016 and 2015 with adequate buffers above the regulatory minimum standards, underpinning the very strong capital position of the Group.

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

In accordance with Basel III, Pillar 2 requirements, the Group has an Internal Capital Adequacy Assessment Process (ICAAP) in place. The ICAAP examines both the current and future capital situation. To assess the latter situation, a four-year forecast is drawn up for required and available capital, both regulatory and economic, according to a basic scenario that takes account of anticipated internal and external growth, and according to various likely alternative scenarios. The Group uses also other instruments as required by Pillar 2 mainly in the area of capital planning, stress testing and risk strategies.

The Basel III agreement and corresponding European CRD IV Directive and Regulation introduced new, more stringent capital requirements for financial institutions. According to these requirements, the legal minimum tier-1 ratio increased to 6.0% (with a common equity ratio of 4.5%). On top of this, a capital conservation buffer, and an extra charge for systemic risks of banks were applied. In addition, a countercyclical buffer (0.5% of Common Equity Tier 1, to be determined by the national regulatory authority) will be introduced in 2017. The Group incorporated major changes / ratios into the regular management of the risk and capital positions.

The Group manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital instruments.

Within the ICAAP approach the capital economic model (ICM – internal capital model) has been developed in KBC Bank in cooperation with the Group. The model is more risk sensitive and built naturally in way that allows decomposition of the undergone credit risk to various categories (like default risk, migration risk, single-name risk, sector and region concentration and diversifications). Model was presented to the regulators and approved. The Group plans to roll out the internal model also for the purpose of the pricing and various business analyses to support business decisions.

Taking into account the planned increase of required capital in 2017, the Bank asked for the first time the ČNB for a permission to retain a part of the net profit as reported in its regulatory financial statements for the year 2016 to the official 2016 prudential results before the audit procedure and annual meeting decision on dividend pay-out. As a consequence of the approval, the ČSOB Tier 1 capital increased by CZK 4,992 m as at 31 December 2016. This corresponds to the retention of approximately one third of the 2016 profit of ČSOB bank.

The following table shows the capital and CAD ratio calculated under Basel III in 2016 and 2015 for the Group.

(CZKm)	2016	2015
Tier 1 capital	68,981	67,036
Tier 2 capital	1,311	1,102
<b>Total capital</b>	<b>70,292</b>	<b>68,138</b>
Regulatory capital requirements	30,318	28,137
<b>Risk weighted assets</b>	<b>378,970</b>	<b>351,718</b>
Capital adequacy ratio	18.55%	19.37%

## SEPARATE FINANCIAL STATEMENTS

### SEPARATE STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

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

(CZKm)	Note	2016	2015
Interest income	4	19,519	20,212
Interest expense	5	(2,835)	(3,412)
<b>Net interest income</b>		<b>16,684</b>	<b>16,800</b>
Fee and commission income	6	8,123	8,470
Fee and commission expense	6	(3,296)	(3,338)
<b>Net fee and commission income</b>		<b>4,827</b>	<b>5,132</b>
Dividend income	13	4,863	5,308
Net gains from financial instruments at fair value through profit or loss and foreign exchange	7	3,379	2,643
Net realised gains on available-for-sale financial assets		1,295	334
Other net income	8	837	473
<b>Operating income</b>		<b>31,885</b>	<b>30,690</b>
Staff expenses	9	(6,234)	(5,789)
General administrative expenses	10	(6,369)	(7,616)
Depreciation and amortisation	20, 21	(947)	(325)
<b>Operating expenses</b>		<b>(13,550)</b>	<b>(13,730)</b>
Impairment losses	11	(431)	(559)
<b>Profit before tax</b>		<b>17,904</b>	<b>16,401</b>
Income tax expense	12	(2,360)	(1,620)
<b>Profit for the year</b>		<b>15,544</b>	<b>14,781</b>

The accompanying notes are an integral part of these separate financial statements.

## SEPARATE STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

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

(CZKm)	Note	2016	2015
<b>Profit for the year</b>		<b>15,544</b>	<b>14,781</b>
Net loss on cash flow hedges	29	(831)	(685)
Net (loss) / gain on available-for-sale financial assets	29	(1,792)	332
Income tax benefit relating to components of other comprehensive income	29	<u>498</u>	<u>67</u>
<b>Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods</b>		<b>(2,125)</b>	<b>(286)</b>
<b>Total comprehensive income for the year, net of tax</b>		<b>13,419</b>	<b>14,495</b>

The accompanying notes are an integral part of these separate financial statements.

## SEPARATE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

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

(CZKm)	Note	2016	2015
<b>ASSETS</b>			
Cash and balances with central banks	14	55,920	116,592
Financial assets held for trading	15	21,716	30,651
Financial assets designated at fair value through profit or loss	15	3,485	3,491
Available-for-sale financial assets	16	73,067	74,389
Held-to-maturity investments	16	132,679	136,432
Loans and receivables	17	698,740	501,668
Fair value adjustments of the hedged items in portfolio hedge		797	866
Investments in subsidiaries, associates and joint ventures	18	46,243	45,773
Derivatives used for hedging	19	11,623	11,906
Property and equipment	20	3,006	2,765
Goodwill and other intangible assets	21	5,249	5,059
Non-current assets held-for-sale	22	35	66
Other assets	23	1,030	1,136
<b>Total assets</b>		<b>1,053,590</b>	<b>930,794</b>
<b>LIABILITIES AND EQUITY</b>			
Financial liabilities held for trading	24	40,068	30,085
Financial liabilities designated at fair value through profit or loss	24	1,620	-
Financial liabilities at amortised cost	25	909,634	797,101
Fair value adjustments of the hedged items in portfolio hedge		4,796	4,062
Derivatives used for hedging	19	10,418	10,668
Current tax liabilities		730	148
Deferred tax liabilities	12	308	870
Other liabilities	26	4,015	4,640
Provisions	27	654	511
<b>Total liabilities</b>		<b>972,243</b>	<b>848,085</b>
Share capital	28	5,855	5,855
Share premium		20,093	20,093
Statutory reserve		18,687	18,687
Retained earnings		32,895	32,132
Available-for-sale reserve	28	1,844	3,296
Cash flow hedge reserve	28	1,973	2,646
<b>Total equity</b>		<b>81,347</b>	<b>82,709</b>
<b>Total liabilities and equity</b>		<b>1,053,590</b>	<b>930,794</b>

The accompanying notes are an integral part of these separate financial statements.

These separate financial statements were approved for issue by the Board of Directors and signed on  
its behalf on 20 April 2017 by:

John Arthur Hollows  
Chairman of the Board of Directors

Jiří Vévoda  
Member of the Board of Directors

## SEPARATE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

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

(CZKm)	Share capital (Note: 28)	Share premium	Statutory reserve <sup>(1)</sup>	Retained earnings	Other reserves (Note: 28)	Total Equity
<b>At 1 January 2015</b>	<b>5,855</b>	<b>14,673</b>	<b>18,687</b>	<b>31,171</b>	<b>6,228</b>	<b>76,614</b>
Profit for the year	-	-	-	14,781	-	14,781
Other comprehensive income for the year	-	-	-	-	(286)	(286)
Total comprehensive income for the year	-	-	-	14,781	(286)	14,495
Increase of Share capital and Share premium	-	5,420	-	-	-	5,420
Acquisition of business under common control (Note: 18)	-	-	-	(612)	-	(612)
Dividends paid (Note: 13)	-	-	-	(13,208)	-	(13,208)
<b>At 31 December 2015</b>	<b>5,855</b>	<b>20,093</b>	<b>18,687</b>	<b>32,132</b>	<b>5,942</b>	<b>82,709</b>
<b>At 1 January 2016</b>	<b>5,855</b>	<b>20,093</b>	<b>18,687</b>	<b>32,132</b>	<b>5,942</b>	<b>82,709</b>
Profit for the year	-	-	-	15,544	-	15,544
Other comprehensive income for the year	-	-	-	-	(2,125)	(2,125)
Total comprehensive income for the year	-	-	-	15,544	(2,125)	13,419
Dividends paid (Note: 13)	-	-	-	(14,781)	-	(14,781)
<b>At 31 December 2016</b>	<b>5,855</b>	<b>20,093</b>	<b>18,687</b>	<b>32,895</b>	<b>3,817</b>	<b>81,347</b>

<sup>(1)</sup> The statutory reserve represents accumulated transfers from retained earnings in compliance with the Statutes of the Bank. This reserve is distributable based on the decision of the Board of Directors.

The accompanying notes are an integral part of these separate financial statements.



## SEPARATE STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2016

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

(CZKm)	Note	2016	2015
<b>OPERATING ACTIVITIES</b>			
Profit before tax		17,904	16,401
Adjustments for:			
Change in operating assets	31	(26,678)	(4,223)
Change in operating liabilities	31	65,205	(14,489)
Non-cash items included in profit before tax	31	3,959	2,405
Net gains from investing activities		(10)	(62)
Income tax paid		(1,692)	(1,644)
<b>Net cash flows from / (used in) operating activities</b>		<b>58,688</b>	<b>(1,612)</b>
<b>INVESTING ACTIVITIES</b>			
Purchase of held-to-maturity investments		(4,848)	(6,589)
Acquisition and equity increase of subsidiary, associate and joint venture companies		(647)	(6,590)
Reintegration of information and communication services (Note: 18)		(955)	(1,136)
Maturity / disposal of investment securities		7,899	13,261
Purchase of property, equipment and intangible assets		(1,509)	(187)
Proceeds from sale and equity decrease of subsidiary, associate and joint venture companies		177	427
Proceeds from disposal of property, equipment, intangible assets and assets held-for-sale		87	611
<b>Net cash flows from / (used in) investing activities</b>		<b>204</b>	<b>(203)</b>
<b>FINANCING ACTIVITIES</b>			
Issue of bonds		500	-
Repayment of bonds		-	(1,500)
Increase of share capital and share premium		-	5,420
Dividends paid	13	(14,781)	(13,208)
<b>Net cash flows used in financing activities</b>		<b>(14,281)</b>	<b>(9,288)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>		<b>44,611</b>	<b>(11,103)</b>
Cash and cash equivalents at the beginning of the year	31	43,404	54,507
Net increase / (decrease) in cash and cash equivalents		44,611	(11,103)
<b>Cash and cash equivalents at the end of the year</b>	31	<b>88,015</b>	<b>43,404</b>
<b>Operational cash flows from interest and dividends</b>			
Interest paid		(2,835)	(3,323)
Interest received		21,031	21,322
Dividends received		4,863	5,308

The accompanying notes are an integral part of these separate financial statements.

## **NOTES TO THE SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

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

### **1. CORPORATE INFORMATION**

Československá obchodní banka, a. s. (the Bank or ČSOB) is a Czech joint-stock company with its registered office at Radlická 333/150, Prague 5, Czech Republic. The Corporate ID is 00001350. The parent company of the Bank is KBC Bank NV (KBC Bank), which is controlled by the KBC Group NV (KBC Group).

The Bank is operating in the Czech Republic. It is a universal bank offering to its clients a wide range of banking products and services, including the products and services of the entire ČSOB Group. The main activities services of the ČSOB include: accepting deposits from the public, providing loans, investing in securities on the Bank's own account, payments and clearance, the issuance and administration of payment instruments, the provision of guarantees, the issuance of letters of credit, the provision of collection services, the provision of all investment service according to a special law, the issuance of mortgage bonds, financial brokerage, the provision of depository services, exchange office services (purchase of foreign exchange), the provision of banking information, trading in foreign exchange values and gold on the Bank's own account or on a client's account, the rental of safe-deposit boxes. Furthermore, the Bank performs activities directly related to the activities described above and activities carried out for other parties if they relate to the running of the Bank and operation of other banks, financial institutions and enterprises providing ancillary banking services, controlled by the Bank.

### **2. ACCOUNTING POLICIES**

#### **2.1 Basis of preparation**

The financial statements have been prepared and approved by the Board of Directors of the Bank. In addition, the financial statements are subject to approval at the General Meeting of shareholders.

The separate financial statements have been prepared under the historical cost convention, except for available-for-sale investments, financial assets and financial liabilities at fair value through profit or loss and all derivative contracts that have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortised cost, are adjusted to record changes in fair value attributable to the risks that are being hedged. Assets held for sale are measured at fair value less cost to sell if this value is lower than their carrying amount (i.e. cost less accumulated depreciation and impairment losses). The separate financial statements are presented in millions of Czech Crowns (CZKm) which is the Bank's presentation currency. The preparation of separate financial statements is required by the Act on Accounting. Simultaneously, the Bank also prepares consolidated financial statements of the ČSOB Group in accordance with the International Financial Reporting Standards as adopted by the European Union (EU IFRS).

#### **Statement of compliance**

The separate financial statements of ČSOB have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

#### **2.2 Significant accounting judgements and estimates**

While applying the Bank accounting policies, the management has used its judgement and made estimates in determining the amounts recognised in the financial statements. The most significant judgements and estimates are as follows:

**Fair value of financial instruments (Note: 30)**

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques which include the application of mathematical models. If possible, the input to these models is taken from observable markets; if not, a degree of judgement is required to establish fair values. The judgements include considerations of credit, liquidity and model inputs such as correlation and volatility for longer-dated financial instruments.

**Impairment losses on financial instruments (Note: 38.2)**

The Bank reviews its financial instruments at each reporting date to assess whether an allowance for impairment should be recorded in the statement of income. In particular, management judgement is required to estimate the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions regarding a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowances, the Bank also makes a collective impairment allowance against exposures which, although not individually identified as requiring a specific allowance, have a greater risk of default than when originally granted.

Management judgement is required to assess the fair value of collateral, which has a significant effect on the impairment allowance.

**Goodwill impairment (Note: 21)**

Goodwill is tested annually for impairment. For this purpose, goodwill acquired in a business combination is allocated to the cash-generating unit which is expected to benefit from the synergies of the combination. A cash-generating unit represents the lowest level within the Bank at which the goodwill is monitored for internal management purposes. Identifying a cash-generating unit as well as determining its recoverable amount requires judgement.

**Impairment of investment in subsidiaries (Note: 18)**

Investments in subsidiaries are reviewed for impairment indicators at least annually. In cases where impairment indicators are identified, investment is tested for impairment by comparing the recoverable amount with the investment carrying amount. Determining and assessing of the impairment indicators as well as determining the recoverable amount requires judgment.

**Assessment of the nature of interest in Group entities**

The Bank considers all relevant facts and circumstances in assessing whether it has a control, joint control (and its type) or significant influence over an investee. The assessment is based on the conclusions made by taking into account the contractual arrangements with the other vote holders of the investee, rights arising from other contractual arrangements and the Bank's voting rights and potential voting rights.

## 2.3 Changes in accounting policies

### Effective from 1 January 2016

The accounting policies adopted are consistent with those used in the previous financial year except for the adoption of the following standards, amendments and interpretations. The adoption of them did not have any effect on the financial performance or position of the Bank, unless otherwise described below.

**Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)** is effective for periods beginning on or after 1 January 2016. The amendment requires an acquirer of an interest in a joint operation to apply all of the principles on business combinations (IFRS 3) except for those that conflict with the guidance in this amendment.

**Equity Method in Separate Financial Statements (Amendments to IAS 27)** is effective for periods beginning on or after 1 January 2016. The amendments reinstate the equity method as an accounting option for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements.

**Disclosure Initiative (Amendments to IAS 1)** is effective for periods beginning on or after 1 January 2016. The amendments clarify that companies should use professional judgment in determining where and in what order information is presented in the financial disclosures. The amendments state that materiality applies to the whole of financial statements and that the inclusion of immaterial information can inhibit the usefulness of financial disclosures.

**Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)** is effective for periods beginning on or after 1 January 2016. The amendment clarifies the use of a revenue-based method for depreciating an asset.

**Annual Improvements to IFRSs (2012 - 2014 Cycle)**, issued in September 2014 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard, all of which are applicable on or after 1 January 2016.

### Effective after 1 January 2016

The following standards, amendments and interpretations have been issued and are effective after 1 January 2016. The Bank has decided not to early adopt them. Unless otherwise described below, the new standards, amendments and interpretations are not expected to significantly affect the Bank financial statements.

**IFRS 9 Financial Instruments (2014)** is effective for periods beginning on or after 1 January 2018. A project relating to IFRS 9 has been running for some time at a group and local level. In 2016, it moved from the design phase to the implementation phase, which will continue in 2017. The project is structured along two pillars: namely classification & measurement and impairment, as well as a common work stream relating to the impact on reporting and disclosures.

#### Classification and measurement of financial instruments

Financial assets are measured at amortised cost if both conditions are fulfilled:

- The financial asset is held within the business model whose objective is to hold the assets to collect the contractual cash flows; and
- The contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal outstanding.

Financial assets are measured at fair value through other comprehensive income if both conditions are fulfilled:

- The financial asset is held within the business model whose objective is to hold the assets to collect the contractual cash flows and to sell; and
- The contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest on the principal outstanding.

Other financial assets are measured at fair value through profit or loss. IFRS 9 retains a fair value option. Reclassifications between the three asset categories are required when the entity changes its business model.

All equity instruments are measured at fair value either through other comprehensive income or profit or loss.

IFRS 9 removes the separation of embedded derivatives requirements for financial assets and the instrument is assessed in its entirety as to whether it fulfils the above two conditions.

Classification and measurement of financial assets under IFRS 9 will depend on the specific business model in place and the assets' contractual cash flow characteristics. The project is in a stage where all business models have been identified, analysed and documented, as to a large extent have the characteristics of cash flows. Based on current market conditions, regulation, interpretation, assumptions and policies, the impact of first time application is currently expected to be limited and would be reflected primarily in a potential rebalancing of the treasury portfolio (reclassification from available-for-sale to amortized cost) and the reversal of frozen available-for-sale reserves. These frozen reserves exist under IAS 39 due to historical reclassifications out of the Available-for-sale category to the held-to-maturity or loans-and-receivables categories, but need to be reversed on transition to IFRS 9.

Financial liabilities are classified and measured either at amortised cost or at fair value through profit or loss. A financial liability can be designated as measured at fair value through profit or loss if doing so results in more relevant information, because either:

- It eliminates or reduces a measurement or recognition inconsistency;
- A group of financial liabilities is managed and its performance is evaluated on a fair value basis.

IFRS 9 requires that changes in the fair value of an entity's own debt, which is designated at fair value through profit or loss, caused by changes in its own credit quality are recognised in other comprehensive income, unless the treatment of the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss.

For financial liabilities, IFRS 9 changes the presentation of gains and losses on own credit risk for financial instruments designated at fair value through profit or loss. The Bank will early adopt this aspect of IFRS 9 with effect from 1 January 2017 and the gains and losses on own credit risk will be recognized as part of other comprehensive income. The Bank is analysing the impact of early adoption of own credit risk.

The original requirements related to the derecognition of financial assets and financial liabilities are carried forward unchanged from IAS 39 to IFRS 9.

### **Impairment of financial assets**

IFRS 9 introduces a three-stage model based on changes in credit quality since initial recognition.

Stage 1 includes financial instruments that have not had a significant increase in credit risk since initial recognition, or have low credit risk at the reporting date. 12-month expected credit losses are recognised for these assets. Interest income is based on the gross carrying amount of the assets.

Stage 2 includes financial instruments that have had a significant increase in credit risk since initial recognition, but that do not have objective evidence of impairment. Lifetime expected credit losses are recognised for these assets. Interest income is still calculated on the gross carrying amount of the assets.

Stage 3 includes financial instruments that have objective evidence of impairment at the reporting date. Lifetime expected credit losses are recognised for these assets. Interest income is calculated on the net carrying amount of the assets.

The new model is applied to debt instruments measured at amortised cost or fair value through other comprehensive income, loan commitments and financial guarantee contracts not measured at fair value through profit or loss and lease/trade receivables. There are simplifications available for trade receivables, lease receivables and contract assets that do not contain a significant financing component. The 12-month expected credit losses do not have to be calculated and lifetime expected credit losses are used instead. For the trade and lease receivables and contract assets with a significant financing component there is a policy choice to apply either the simplified or general model.

The accounting for impairment of financial assets will have a significant impact on the Bank. The assessment is in progress.

The Bank has established policies and processes to assess whether credit risk has increased significantly at the end of each reporting period and, therefore, “staging” is required (i.e. moving from one stage to another). For the loan portfolio, a multi-tier approach has been adopted to staging, based on internal credit ratings, forbearance measures, collective assessment and days past due as a backstop. A similar multi-tier approach will be used for the investment portfolio except that the Bank intends to use the low-credit-risk exemption, meaning that all bonds in scope with a probability of default grade (PD) of 1 to 3 are considered to be in Stage 1, unless any of the other triggers indicate otherwise. For Stage 1 and Stage 2 - under IAS 39 - the Bank records incurred-but-not-reported (IBNR) impairment losses, which are influenced by emergence periods. Under IFRS 9, impairment of financial assets is calculated on a 12-month expected credit loss (ECL) basis for Stage 1 and on a lifetime ECL basis for Stage 2. As a consequence, impairment levels are generally expected to increase. The Bank does not expect any major impact on Stage 3.

#### Hedge accounting

The Bank intends to use the option to continue with hedge accounting under IAS 39 and to await further developments at the IASB regarding macro hedging.

**Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)** does not yet have a set effective date. The amendments clarify the accounting for transactions where a parent loses control of a subsidiary that does not constitute a business as defined in IFRS 3. The gain or loss resulting from the sale or contribution to an associate or a joint venture of assets is recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in the associate or joint venture.

**IFRS 15 Revenue from Contracts with Customers** is effective for periods beginning on or after 1 January 2018. The key concept of the new standard is identifying separate Performance Obligations. Entities will follow a five-step model for revenue recognition:

1. Identify the contract with the customer (a contract exists only when it is 'probable' that the entity will collect the consideration);
2. Identify separate Performance Obligations in the contract (a promise to transfer good or service);
3. Determine the transaction price (only an amount not subject to subsequent future reversals);
4. Allocate the transaction price to each Performance Obligation;
5. Recognise revenue when or as each Performance Obligation is satisfied.

As the standard is not applicable to insurance contracts, financial instruments or lease contracts, the impact on the Bank will be limited. The assessment of the impact is in progress.

**IFRS 16 Leases** is effective for annual periods beginning on or after 1 January 2019 and has not yet been endorsed by the EU. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognize most leases in their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The Bank is currently assessing the impact that IFRS 16 will have on the financial statements.



**Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)** is effective for annual periods beginning on or after 1 January 2018 and has not yet been endorsed by the EU. The amendment permits insurers that meet specified criteria to apply a temporary exemption from IFRS 9. Further it permits insurers to apply the overlay approach to designated financial assets and to reclassify in specified circumstances some or all of their financial assets so that the assets are measured at fair value through profit or loss.

**Clarifications to IFRS 15 (Amendment to IFRS 15)** is effective for periods on or after 1 January 2018. The amendment clarifies three separate topics within the IFRS 15: how to assess control in principal versus agent considerations; when an entity's activities significantly affect intellectual property in licensing agreements and expands a definition of what "distinct goods and services" mean.

**Disclosure Initiative (Amendment to IAS 7)** is effective for periods on or after 1 January 2017. The amendment requires that the following changes in liabilities arising from financing activities are disclosed: (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

**Recognition of Deferred Tax Assets for Unrealised Losses (Amendment to IAS 12)** is effective for periods on or after 1 January 2017. The amendment addresses the question of whether an unrealised loss on a debt instrument measured at fair value gives rise to a deductible temporary difference.

**Transfers of Investment Property (Amendment to IAS 40)** is effective for periods on or after 1 January 2018. The amendment clarifies the guidance on transfers to or from investment properties, in terms of the definition of "changes in use".

**IFRIC 22 Foreign Currency Transactions and Advance Consideration** is effective for periods on or after 1 January 2018. The interpretation gives a guidance on determining a date of transaction for the purpose of determining the exchange rate in transactions involving advance consideration in foreign currency.

**Annual Improvements to IFRS Standards (2014 - 2016 Cycle)**, issued in December 2016 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard, two of which are applicable on or after 1 January 2018 and one on or after 1 January 2017.



## 2.4 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these separate financial statements are set out below.

### (1) Foreign currency translation

Items included in the financial statements of the Bank are initially measured using the currency of the primary economic environment in which the Bank operates ("the functional currency").

Transactions in foreign currencies are initially recorded at the functional currency rate of exchange prevailing at the date of transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange prevailing at the end of the reporting period. All differences are taken to Net gains/losses from financial instruments at fair value through profit or loss and foreign exchange (Net gains/losses from financial instruments at fair value through profit or loss onwards) in the statement of income with the exception of differences in foreign currency borrowing or derivatives that provide an effective hedge in the cash flow hedge of currency risk, which are taken through OCI directly to equity until the hedged cash flow influences the statement of income, at which time they are recognised in the statement of income as well.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates prevailing at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates prevailing at the end of the reporting period. Exchange differences from non-monetary available-for-sale financial assets are included in the fair value revaluation recognised in equity until the assets are derecognised or impaired.

### (2) Investments in subsidiaries, associates and jointly controlled entities

A subsidiary is an entity which is controlled by the Bank (parent entity). The Bank controls an investee when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Associates are all entities over which the Bank has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. A contractual arrangement between the venturers establishes joint control over the economic activity of the entity. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

Investments in subsidiaries, associates and joint ventures are carried at cost less any provision for impairment. Dividends received from investments in subsidiaries, associates and joint ventures are recorded in Dividend income.

### (3) Financial instruments - recognition and derecognition

Financial assets and liabilities are recognised in the statement of financial position when the Bank becomes a party to the contractual provisions of the financial instrument, except for "regular way" purchases and sales of financial assets (see below). A financial asset is derecognised from the statement of financial position when the contractual rights to the cash flows from the financial asset expire or are transferred and the transfer qualifies for derecognition. A transfer requires that the Bank either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Bank assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been neither retained nor transferred, the Bank assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognised. Where the Bank has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement. A financial liability is derecognised from the statement of financial position when the obligation specified in the contract is discharged, cancelled or expires.

A "regular way" purchase or sale of a financial asset is one in which the delivery of the asset is made within the time frame generally established by regulation or convention of the particular market concerned. For all categories of financial assets the Bank recognises "regular way" purchases and sales using settlement date accounting. Under settlement date accounting, a financial asset is recognised or derecognised in the statement of financial position on the day it is physically transferred to or from the Bank ("settlement date"). The date on which the Bank becomes a party to the contractual provisions of a financial asset purchase or the Bank loses control of the contractual rights from a financial asset sale is commonly referred to as the "trade date". For financial assets at fair value through profit or loss and available-for-sale financial assets, fair value movements between the "trade date" and "settlement date" in connection with purchases and sales are recognised in Net gains / losses from financial instruments at fair value through profit or loss and in the Available-for-sale reserve, respectively. On the settlement date, a respective financial asset or liability is recognised in or derecognised from the statement of financial position.

#### **(4) Financial instruments - initial recognition and subsequent measurement**

The classification of financial instruments depends on the purpose for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, any directly attributable incremental costs of acquisition or issue.

##### *(i) Financial assets or financial liabilities at fair value through profit or loss*

This category has two sub-categories: financial assets and financial liabilities held for trading, and those designated at fair value through profit or loss at inception.

Financial assets or financial liabilities held for trading consist of derivatives held for trading and financial instruments other than derivatives held for trading.

- *Derivatives held for trading*

Derivatives include foreign exchange contracts, interest rate futures, forward rate agreements, currency and interest rate swaps, and currency, interest rate and commodity options. Derivatives are recorded at fair value and carried as assets when the fair value is positive and as liabilities when the fair value is negative. Changes in the fair value of derivatives held for trading are included in Net gains/losses from financial instruments at fair value through profit or loss.

Changes in the clean fair value (fair value less any net interest accrual) of derivatives used as economic hedges are recognised in Net gains/losses from financial instruments at fair value through profit or loss. Net interest income/expense from these derivatives is recorded in Net interest income on a deal by deal basis.

The derivatives used as economic hedges are derivatives, which do not meet the IFRS requirements for applying hedge accounting but which the Bank Asset Liability Management department uses for decreasing the interest rate risk of the Bank, and thus lowering net interest income volatility, i.e. for hedging purposes from an economic point of view.

The Bank occasionally purchases or issues financial instruments containing embedded derivatives. An embedded derivative is separated from the host contract and carried at fair value if the economic characteristics of the derivative are not closely related to the economic characteristics of the host contract and the hybrid instrument is not classified as at fair value through profit or loss. If a separated derivative does not qualify as a hedging derivative, it is designated as a trading derivative. To the extent that the Bank cannot reliably identify and measure the embedded derivative, the entire contract is carried at fair value in the statement of financial position with changes in fair value reflected in the statement of income.

- *Financial instruments held for trading other than derivatives*

Financial assets or financial liabilities held for trading other than derivatives are recorded in the statement of financial position at fair value. Changes in clean fair value are recognised in Net gains/losses from financial instruments at fair value through profit or loss. Interest income or expense is recorded in Net interest income using the effective interest rate method. Dividends received are recorded in Dividend income. A financial asset or financial liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the near term.

- *Financial instruments designated at fair value through profit or loss*

Financial assets and financial liabilities designated at fair value through profit or loss on initial recognition are classified in this category when the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis; or
- the assets and liabilities are part of a group of financial assets, financial liabilities, or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in clean fair value are recorded in Net gains / losses from financial instruments at fair value through profit or loss. Interest income or expense is recorded in Net interest income using the effective interest rate method.

*(ii) Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. Were the Bank to sell or reclassify other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available-for-sale.

After initial measurement, held-to-maturity investments are measured at amortised cost using the effective interest rate method, less any allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in Interest income. The losses arising from the impairment of such investments are recognised in the statement of income in Impairment losses.

*(iii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Bank has no intention of trading the financial asset.

After initial measurement, loans and receivables are measured at amortised cost using the effective interest rate method, less any allowance for impairment, except in the case of a fair value hedge of items in this category, which have to be fair valued to the extent of the hedged risk. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in Interest income. The losses arising from the impairment of such investments are recognised in the statement of income in Impairment losses.

*(iv) Available-for-sale financial assets*

Available-for-sale financial assets are those which are designated as such or do not qualify to be classified as designated at fair value through profit or loss, held-to-maturity or loans and receivables.

After initial measurement, available-for-sale financial assets are measured at fair value. Unrealised gains and losses are recognised directly in equity in the Available-for-sale reserve on an after-tax basis, until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the statement of income. When an available-for-sale asset is disposed of, the unrealised gain or loss recorded in the Available-for-sale reserve is reclassified to Net realised gains / losses on available-for-sale financial assets. Interest income arising from available-for-sale assets, calculated using the effective interest rate method is recorded separately in Net interest income. Dividends received from available-for-sale equity shares are recorded in Dividend income.

*(v) Financial liabilities at amortised cost*

Financial liabilities at amortised cost are non-derivative financial liabilities where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder.

After initial measurement, those financial liabilities are measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

(vi) *'Day 1' profit or loss*

Where the transaction price in a non-active market is different to the fair value from other observable current market transactions in the same instrument, or the fair value based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and the fair value (a Day 1 profit or loss) in the statement of income in Net gains/losses from financial instruments at fair value through profit or loss. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognised in the statement of income when the inputs become observable, or when the instrument is derecognised.

**(5) Repurchase and reverse repurchase agreements**

Securities sold under agreements to repurchase at a specified future date (repos) remain in the statement of financial position. The corresponding cash received is recognised in the statement of financial position in Financial liabilities held for trading, or Financial liabilities at amortised cost, reflecting its economic substance as a loan to the Bank. The difference between the sale and repurchase price is recorded as Interest expense and is accrued over the life of the agreement.

Conversely, securities purchased under agreements to resell at a specified future date (reverse repos) are not recognised in the statement of financial position. The corresponding cash paid is recognised in the statement of financial position in Financial assets held for trading or Loans and receivables or Cash and balances with central banks. The difference between the purchase and resale price is recorded as Interest income and is accrued over the life of the agreement.

**(6) Determination of fair value**

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (ie an exit price). Financial instruments classified as financial assets and financial liabilities at fair value through profit or loss or available-for-sale are fair valued using quoted market prices if there is a published price quotation in an active market. For financial instruments that are not traded on an active market their fair values are estimated using pricing models, utilising quoted prices of instruments with similar characteristics, discounted cash flows methods or other models. Those fair value estimation techniques are significantly affected by assumptions used by the Bank including the discount rate, liquidity and credit spreads and estimates of future cash flows.

**(7) Impairment of financial assets**

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of assets that can be reliably estimated. Objective evidence that a financial asset or a group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the Bank would not otherwise consider;
- it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - adverse changes in the payment status of borrowers in the group; or
  - national or local economic conditions that correlate with defaults on the assets in the group.

(i) *Assets carried at amortised cost*

The Bank assesses objective evidence of impairment individually or collectively for financial assets at amortised cost. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of income. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period. The assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recorded in the statement of income.

When a loan is uncollectible, it is written off against the related allowance for impairment. Such loans are written off after all the necessary procedures for collecting the loan have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the statement of income in Impairment losses.

(ii) *Renegotiated loans*

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due, however, the rating of the client cannot be improved only based on the restructuring. The management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject of an individual or collective impairment assessment, calculated using the loan's original effective interest rate.



*(iii) Financial assets carried at fair value*

The Bank assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of a debt instrument classified as available-for-sale, the assessment of impairment is based on the same criteria as financial assets carried at amortised cost. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. A significant decline is considered to be a 30% decline in the fair value. A prolonged decline is considered to be a decline of one year or longer. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the statement of income - is removed from equity and recognised in the statement of income. Impairment losses recognised in the statement of income on equity instruments are not reversed through the statement of income. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of income, the impairment loss is reversed through the statement of income.

**(8) Impairment of non-financial assets**

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. The recoverable amount is determined for an individual asset.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Bank makes an estimate of the recoverable amount.

A previous impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of income.

**(9) Hedge accounting**

The Bank uses instruments, designated as hedging instruments as cash flow hedges or fair value hedges to manage the Bank's interest rate risk or foreign currency risk. Cash flow hedges and fair value hedges are used to minimise the variability in cash flows of interest-earning assets or interest-bearing liabilities or anticipated transactions caused by interest rate fluctuations or to minimise the variability in the fair value of asset or liability, which could affect the statement of income. Hedge accounting is used for derivatives and other financial instruments designated in this way provided certain criteria are met. The Bank's criteria for the application of hedge accounting include:

- formal documentation of the hedging instrument, hedged item, hedging objective, strategy and relationship is prepared before hedge accounting is applied;
- the hedge is documented at inception showing that it is expected to be highly effective in offsetting the risk in the hedged item throughout the reporting period;
- the hedge is highly effective on an ongoing basis. The hedge is considered to be highly effective if the Bank achieves offsetting changes in cash flows between 80% and 125% for the risk being hedged.

The Bank has complied with the amended standard, taking into account the 'carved out' parts as approved by the European Commission.

(i) *Cash flow hedges*

The effective portion of the change in fair value of a cash flow hedging derivative is recorded in the Cash flow hedge reserve. The ineffective portion is recorded directly in Net gains/losses from financial instruments at fair value through profit or loss. Amounts in the Cash flow hedge reserve are reclassified into the statement of income in a manner consistent with the earnings recognition pattern of the underlying hedged item. If a cash flow hedge is terminated or the hedge designation removed the related remaining amounts in the Cash flow hedge reserve are reclassified into the statement of income in the same period during which the hedged item affects income. If the hedged anticipated transaction is no longer expected to occur the related remaining amounts in the Cash flow hedge reserve are recognised immediately in the statement of income.

(ii) *Fair value hedges*

For designated and qualifying fair value hedges, the change in the fair value of a hedging instrument is recognised in the statement of income. Related interest income / expense from the hedging instrument is recorded in Net interest income, revaluation of the hedging instrument is recognised in Net gains / losses from financial instruments at fair value through profit or loss. Meanwhile, the change in fair value of the hedged item attributable to the risk hedged is recorded as part of the carrying value of the hedged available-for-sale financial asset or on a separate line Fair value adjustments of the hedged items in portfolio hedge if the hedged item is financial asset or liability measured at amortised cost. The change in fair value of the hedged item and is also recognised in the statement of income in Net gains/losses from financial instruments at fair value through profit or loss. If the hedging instrument expires, is sold, terminated or exercised or if the hedge is not assessed as effective any more, then the hedge accounting is discontinued.

For fair value hedges relating to items carried at amortised cost, any adjustment to the carrying value is amortised through the statement of income over the remaining term of the hedge using the effective interest rate method. Amortisation begins as soon as an adjustment exists but no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. If the hedged item is derecognised, the unamortised fair value is recognised immediately in the statement of income.

**(10) Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

**(11) Reclassification of financial assets**

The Bank does not reclassify any financial assets into or out of the Financial assets designated at fair value through profit or loss after initial recognition.

If a non-derivative financial asset at fair value through profit or loss is no longer held for selling or repurchasing it can only be reclassified in rare circumstances.

The Bank can also reclassify, under certain circumstances, financial assets out of Available-for-sale. A financial asset classified as Available-for-sale that would have met the definition of loans and receivables may be reclassified out of the Available-for-sale category to the loans and receivables category if the Bank has the intention and ability to hold the financial asset for the foreseeable future or until maturity. A financial asset classified as Available-for-sale that would have met the definition of held-to-maturity investment may be reclassified out of the Available-for-sale category to the held-to-maturity investment category if the Bank has the intention and ability to hold the financial asset until maturity.

Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

For a financial asset reclassified out of the Available-for-sale category, any previous gain or loss on that asset that has been recognised in equity is amortised in the statement of income over the remaining life of the investment using the effective interest rate. Any difference between the new amortised cost and the expected cash flow is also amortised over the remaining life of the asset using the effective interest rate.



Sales and reclassifications from the Held-to-maturity portfolio without the risk of triggering tainting rules are possible only in limited circumstances, such as when it concerns an insignificant amount of instruments or instruments that are so close to maturity that the changes in the market interest rates would not significantly change their fair value. Further, no tainting rules are applied if the sales or reclassifications are attributable to an isolated event that is beyond the Bank's control (i.e. significant deterioration in the issuer's creditworthiness or changes in tax, statutory or regulatory requirements) or if the sales occur after collecting a substantial amount of the instrument's principal.

However, if sales or reclassifications from the Held-to-maturity portfolio do not fulfil the above limits, any remaining investments have to be reclassified as available-for-sale. Furthermore, no financial assets can be classified as Held-to-maturity for the following two years.

### **(12) Leasing**

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

#### *(i) Bank as a lessee*

The leases entered into by the Bank are primarily operating leases. The total payments made under operating leases are charged to the statement of income on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

#### *(ii) Bank as a lessor*

Leases, in which the Bank does not transfer substantially all the risks and benefits of ownership of the asset, are classified as operating leases. The Bank leases out certain of its properties under operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned. Rental income is included in Other net income.

### **(13) Recognition of income and expenses**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

#### *(i) Interest income and expense*

For all financial instruments measured at amortised cost and interest bearing financial instruments classified as available-for-sale financial investments, interest income or expense is recorded using the effective interest rate method.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest income and expense of interest-bearing non-derivative financial instruments in the held-for-trading portfolio designated at fair value through profit or loss portfolio, derivatives used as economic hedges and hedging derivatives are also recognised in the caption using the effective interest rate method.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

*(ii) Fee and commission income*

Fees and commissions that are not an integral part of the effective interest rate are generally recognised on an accrual basis when the service has been provided. Origination fees for loans that are probable of being drawn down, are deferred and recognised as an integral part of the effective interest on the loan. Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, are recognised on the completion of the underlying transaction. Recognition of portfolio and other management advisory and service fees is based on the applicable service contracts. Asset management fees relating to investment funds are accrued over the period for which the service is provided. Commissions from sales of insurance products are recognised based on the applicable contract and accrued over the contractual period.

*(iii) Dividend income*

Revenue is recognised when the Bank's right to receive a payment is established.

*(iv) Net gains / losses from financial instruments at fair value through profit or loss*

Net gains / losses from financial instruments at fair value through profit or loss include all gains and losses from changes in the clean fair value of financial assets and financial liabilities held for trading and those designated at fair value through profit or loss except for trading derivatives that are not used as economic hedges, where the interest income/expense is also included. This caption also includes net gains from fair value hedging constructions (revaluation of hedging and hedged items) and any ineffectiveness recorded in cash flow hedging transactions.

**(14) Cash and cash equivalents**

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 3 months maturity from the date of acquisition including: cash and balances with central banks loans and advances to credit institutions and central banks (measured at amortised cost) and financial liabilities at amortised cost to credit institutions and central banks. Only highly liquid transactions contracted with general government bodies (reverse repo / repo operations) are assessed by the Bank as cash equivalents.

**(15) Property and equipment**

Property and equipment includes Bank occupied properties, IT and communication and other machines and equipment.

Land is carried at cost. Buildings and equipment are carried at cost less accumulated depreciation and impairment, if any. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Depreciation is calculated using the straight-line method to write off the cost of each asset to its residual value over its estimated useful life, as follows:

Buildings	30 years
IT equipment	4 years
Office equipment	10 years
Other	4-30 years

Gains and losses on disposals are determined by comparing the proceeds received in the transaction with the carrying amount of the asset. The resulting gains and losses are included as a net amount in Other net income.

Property and equipment is reviewed for impairment at the end of each reporting period or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

When it is highly probable that an asset will be sold, the asset is classified in Non-current assets held-for-sale at the lower of its carrying amount and fair value less costs to sell.

## (16) Business combinations and Goodwill

Business combinations are generally reflected in separate financial statements only if the Bank acquires business that doesn't represent separate legal entity.

The acquisition method of accounting is used to account for the acquisition of businesses by the Bank that are not under common control as the Bank was. The cost of an acquisition is measured as the total of the fair values of assets transferred, equity instruments issued and liabilities incurred or assumed at the date of exchange. Non-controlling interests in the acquirees are measured at the proportionate share of the acquiree's recognised net identifiable assets. Any acquisition-related costs are recognised in the statement of income when they are incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

Goodwill as of the acquisition date is measured as the excess of the aggregate of the consideration transferred and the amount of non-controlling interest over the net of the identifiable assets acquired and the liabilities assumed at the date of acquisition.

If a bargain purchase is made, in which the net of the acquisition-date amounts of identifiable assets acquired and liabilities assumed is larger than the aggregate of the consideration transferred and the amount of non-controlling interest in the acquiree, the resulting gain is recognised in the statement of income at the date of acquisition.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to the cash-generating unit which is expected to benefit from the synergies of the combination. A cash-generating unit represents the lowest level within the Bank at which the goodwill is monitored for internal management purposes.

Impairment losses relating to goodwill cannot be reversed in future periods.

The pooling of interest method of accounting is used to account for the business combination of entities or businesses under common control. It means a business combination in which all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination.

The assets and liabilities of the combining entities are reflected at their carrying amounts and no new assets and liabilities are recognized at the date of combination. No new goodwill is recognised as a result of the combination.

Any difference between the consideration paid and the carrying amounts of assets and liabilities acquired is reflected through equity.

The income statement reflects the results of the combining entities only since the date, when the control was obtained by the reporting entity.

## (17) Intangible assets

Intangible assets include software, licences and other intangible assets. A core system is a large-scale software application that performs important strategic group objectives.

Development costs that are directly associated with identifiable and unique software controlled by the Bank are recorded as intangible assets if the inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred.

Intangible assets are carried at cost less accumulated amortisation and impairment, if any. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

The amortisation of software and other intangible assets is calculated using the straight-line method to write off the cost of each asset to its residual value over its estimated useful life, as follows:

Core systems	8 years
Other software	4 years
Other intangible assets	5 years

Gains and losses on disposals are determined by comparing proceeds received in the transaction with the carrying amount of the asset. The resulting gains and losses are included as a net amount in Other net income.

### **(18) Financial guarantees**

In the ordinary course of business, the Bank provides financial guarantees consisting of letters of credit and letters of guarantee. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. At the end of each reporting period, financial guarantees are measured in the financial statements at the higher of the amortised premium and the best estimates of expenditure required to settle any financial obligation arising as a result of the guarantee and are presented in Provisions. Fees are recognised in the statement of income in Fee and commission income. Any increase or decrease in the provision relating to financial guarantees is included in Impairment losses.

### **(19) Employee retirement benefits**

#### *Retirement benefits*

Pensions are provided by the Czech Republic to resident employees financed by salary-based social security contributions of the employees and their employers.

The Bank contributes to a defined contribution retirement benefit scheme for participating employees, in addition to the employer social security contributions required by the law in the Czech Republic. Contributions are charged to the statement of income as they are made.

#### *Termination benefits*

Employees dismissed by their employer are entitled to termination benefits equal to or less than three times the employees's month's average salary in accordance with the Czech employment law. Employees employed over ten years are entitled to additional termination benefits, which are scaled in accordance of the years of service. Termination benefits are recognised in the statement of income based on the approval of the restructuring programme implementation.

### **(20) Provisions**

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

### **(21) Income tax**

There are two components of income tax expense: current and deferred. Current income tax expense approximates amounts to be paid or refunded for taxes for the appropriate period.

Deferred tax assets and liabilities are recognised due to differences between the tax bases of assets and liabilities and their respective carrying amounts in the financial statements. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss,
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not be reversed in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, except:

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss,

- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will be reversed in the foreseeable future and the taxable profit will be available against which the temporary differences can be utilised.

All deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the deferred tax assets can be utilised. Deferred tax assets and liabilities are offset in the financial statements where a right of set-off exists.

Deferred tax related to the fair value movements of cash flow hedges and available-for-sale securities, which are charged or credited to OCI, is also credited or charged to OCI and is subsequently recognised in the statement of income together with the deferred gain or loss.

The Bank records a net deferred tax asset under Deferred tax assets and a net deferred tax liability under Deferred tax liabilities.

#### **(22) Share capital and reserves**

The issued capital (registered, subscribed and paid) as at the end of the reporting period is accounted for at an amount recorded in the Commercial register.

The statutory reserve fund is accumulated in compliance with the Statutes of the Bank and its use is limited by the Articles of association or Statutes. The fund is distributable based on the decision of the Board of Directors.

Dividends are recognised after they have been ratified by the resolution of the sole shareholder.

#### **(23) Fiduciary activities**

The Bank commonly acts in fiduciary activities that result in the holding or placing of assets on behalf of individuals and institutions. The assets and income arising thereon are excluded from these financial statements, as they are not assets of the Bank.

#### **(24) Operating segments**

Operating segments are components of the Bank that engage in business activities from which they earn revenues and incur expenses and whose operating results are regularly reviewed on the Bank level to assess their performance. Discrete information is available for each operating segment.

### **3. SEGMENT INFORMATION**

The Bank's primary segment reporting is by customer segment.

The Bank has four reportable segments, as described below, which are the Bank's strategic business units. The strategic business units offer different products and services, and are managed separately based on the Bank's management and internal reporting (controlling) structure. For each of the strategic business units, the Bank's management reviews internal management reports on a quarterly/monthly basis.

Management monitors the operating result of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects is measured differently from operating profit or loss in the separate financial statements. Income tax is allocated to operating segments, but is managed on a Bank basis.

#### **Definitions of customer operating segments:**

**Retail:** Private individuals and entrepreneurs, except of private banking customers that are reported as a part of Relationship services. This segment contains customers' deposits, consumer loans, overdrafts, payment solutions including payment cards, mortgages and other transactions and balances with retail customers. Margin income from operations with retail clients on the financial market is also allocated to this segment (i.e. a margin from spot operations, hedging of foreign currency transactions and trading with bonds).

**Relationship services:** Corporate companies with a turnover of greater than CZK 300 m, SME companies with a turnover of less than CZK 300 m, private banking customers with financial assets above CZK 10 m, financial and public sector institutions. This segment contains customers' deposits, loans, overdrafts, payment solutions including payment cards and other transactions and balances with corporate, SME customers and private banking customers. Margin income from the operations with corporate, SME clients and private banking clients on the financial market is also allocated to this segment (i.e. a margin from spot operations, hedging of foreign currency transactions or trading with bonds).

**Financial markets:** This segment contains investment products and services to institutional investors and intermediaries and fund management activities and trading included in dealing services.

**Group Centre:** The Group Centre segment consists of positions and results of Asset Liability Management (ALM), the results of the reinvestment of free equity of the Bank, dividends from subsidiaries, associates and joint ventures and items not directly attributable to other segments.

In 2016, non-manageable costs (i.e. Internal audit, Human Resources, Finance and other related Common Costs) representing a part of other operating expenses previously allocated into segments started to be reported at Group Centre. Comparative figures in the Statement of income for 2015 have been reclassified.

#### Segment reporting information by customer segments for 2016

(CZK m)	Retail	Relationship services	Financial markets	Group Centre	Total
<b>Statement of income</b>					
Net interest income	7,338	7,361	(36)	2,021	16,684
Net fee and commission income	2,229	2,306	318	(26)	4,827
Dividend income	-	-	-	4,863	4,863
Net gains from financial instruments at fair value through profit or loss	511	1,533	912	423	3,379
Net realised gains on available-for-sale financial assets	-	-	-	1,295	1,295
Other net income	36	3	-	798	837
<b>Operating income</b>	<b>10,114</b>	<b>11,203</b>	<b>1,194</b>	<b>9,374</b>	<b>31,885</b>
<i>of which:</i>					
<i>External operating income</i>	<i>4,510</i>	<i>9,169</i>	<i>1,194</i>	<i>17,012</i>	<i>31,885</i>
<i>Intersegment operating income</i>	<i>5,604</i>	<i>2,034</i>	<i>-</i>	<i>(7,638)</i>	<i>-</i>
Depreciation and amortisation	(37)	(1)	-	(909)	(947)
Other operating expenses	(6,774)	(3,648)	(233)	(1,948)	(12,603)
<b>Operating expenses</b>	<b>(6,811)</b>	<b>(3,649)</b>	<b>(233)</b>	<b>(2,857)</b>	<b>(13,550)</b>
Impairment losses - additions	(364)	(1,740)	-	(305)	(2,409)
Impairment losses - reversals	451	1,136	-	391	1,978
<b>Profit before tax</b>	<b>3,390</b>	<b>6,950</b>	<b>961</b>	<b>6,603</b>	<b>17,904</b>
Income tax expense	(644)	(1,320)	(182)	(214)	(2,360)
<b>Segment profit</b>	<b>2,746</b>	<b>5,630</b>	<b>779</b>	<b>6,389</b>	<b>15,544</b>
<b>Assets and liabilities</b>					
Segment assets	23,737	231,728	21,231	776,859	1,053,555
Non-current assets held-for-sale	-	-	-	35	35
<b>Total assets</b>	<b>23,737</b>	<b>231,728</b>	<b>21,231</b>	<b>776,894</b>	<b>1,053,590</b>
<b>Total liabilities</b>	<b>365,420</b>	<b>312,778</b>	<b>40,981</b>	<b>253,064</b>	<b>972,243</b>
<b>Capital expenditure</b>	<b>254</b>	<b>15</b>	<b>-</b>	<b>1,239</b>	<b>1,508</b>



**Segment reporting information by customer segments for 2015**

(CZKm)	Retail	Relationship services	Financial markets	Group Centre	Total
<b>Statement of income</b>					
Net interest income	7,484	7,235	208	1,873	16,800
Net fee and commission income	2,535	2,222	288	87	5,132
Dividend income	-	-	-	5,308	5,308
Net gains / (losses) from financial instruments at fair value through profit or loss	457	1,394	808	(16)	2,643
Net realised gains on available-for-sale financial assets	-	-	-	334	334
Other net income	33	16	-	424	473
<b>Operating income</b>	<b>10,509</b>	<b>10,867</b>	<b>1,304</b>	<b>8,010</b>	<b>30,690</b>
<i>of which:</i>					
<i>External operating income</i>	<i>4,379</i>	<i>8,982</i>	<i>1,304</i>	<i>16,025</i>	<i>30,690</i>
<i>Intersegment operating income</i>	<i>6,130</i>	<i>1,885</i>	<i>-</i>	<i>(8,015)</i>	<i>-</i>
Depreciation and amortisation	(36)	(1)	-	(288)	(325)
Other operating expenses	(7,369)	(3,699)	(259)	(2,079)	(13,405)
<b>Operating expenses</b>	<b>(7,405)</b>	<b>(3,700)</b>	<b>(259)</b>	<b>(2,367)</b>	<b>(13,730)</b>
Impairment losses - additions	(475)	(1,209)	-	(21)	(1,705)
Impairment losses - reversals	328	767	-	51	1,146
<b>Profit before tax</b>	<b>2,957</b>	<b>6,725</b>	<b>1,045</b>	<b>5,673</b>	<b>16,401</b>
Income tax (expense) / benefit	(562)	(1,278)	(199)	419	(1,620)
<b>Segment profit</b>	<b>2,395</b>	<b>5,447</b>	<b>846</b>	<b>6,092</b>	<b>14,781</b>
<b>Assets and liabilities</b>					
Segment assets	19,721	226,657	30,435	653,915	930,728
Non-current assets held-for-sale	-	-	-	66	66
<b>Total assets</b>	<b>19,721</b>	<b>226,657</b>	<b>30,435</b>	<b>653,981</b>	<b>930,794</b>
<b>Total liabilities</b>	<b>336,713</b>	<b>293,698</b>	<b>30,061</b>	<b>187,613</b>	<b>848,085</b>
<b>Capital expenditures</b>	<b>61</b>	<b>4</b>	<b>-</b>	<b>84</b>	<b>149</b>

Interest income and interest expense are not presented separately since the Bank assesses the performance of the segments primarily on the basis of the net interest income.

Intersegment transactions are transactions conducted between the different primary segments on an arm's length basis.

The Bank operates predominantly in the Czech Republic.



#### 4. INTEREST INCOME

(CZKm)	2016	2015
Cash balances with central banks	53	19
Loans and receivables		
Credit institutions	2,390	2,865
Other than credit institutions	7,594	7,868
Available-for-sale financial assets	1,610	1,818
Held-to-maturity investments	5,091	5,397
Financial assets held for trading (Note: 7)	345	371
Financial assets designated at fair value through profit or loss (Note: 7)	60	151
Derivatives used as economic hedges (Note: 7)	148	161
Derivatives used for hedging (Note: 7)	1,854	1,562
Negative interest from financial liabilities measured at amortised cost	349	-
Negative interest from financial liabilities measured at fair value (Note: 7)	25	-
	<b>19,519</b>	<b>20,212</b>

#### 5. INTEREST EXPENSE

(CZKm)	2016	2015
Financial liabilities at amortised cost		
Central banks	-	2
Credit institutions	483	564
Other than credit institutions	835	1,331
Debt instruments in issue	66	43
Discount amortisation on other provisions (Note: 27)	3	3
Financial liabilities held for trading (Note: 7)	414	280
Derivatives used as economic hedges (Note: 7)	77	202
Derivatives used for hedging (Note: 7)	953	987
Negative interest from financial assets measured at fair value (Note: 7)	4	-
	<b>2,835</b>	<b>3,412</b>

#### 6. NET FEE AND COMMISSION INCOME

(CZKm)	2016	2015
<b>Fee and commission income</b>		
Payment services	5,290	5,624
Administration of credits	1,144	1,166
Collective investments	664	768
Securities	204	220
Custody	185	178
Asset management	79	68
Other	557	446
	<b>8,123</b>	<b>8,470</b>
<b>Fee and commission expense</b>		
Payment services	1,481	1,750
Retail service fees	1,017	986
Commissions to agents	54	48
Other	744	554
	<b>3,296</b>	<b>3,338</b>
<b>Net fee and commission income</b>	<b>4,827</b>	<b>5,132</b>

## 7. NET GAINS FROM FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS AND FOREIGN EXCHANGE

Net gains from financial instruments at fair value through profit or loss, as reported in the statement of income, do not include net interest income recognised on financial assets and financial liabilities at fair value through profit or loss. Net gains from financial instruments at fair value through profit or loss and the related net interest income are set out in the table below to provide a fuller presentation of the net result from financial instruments at fair value through profit or loss of the Bank:

(CZKm)	2016	2015
<b>Net gains from financial instruments at fair value through profit or loss and foreign exchange - as reported</b>	<b>3,379</b>	<b>2,643</b>
Net interest income (Notes: 4, 5)	984	776
	<b>4,363</b>	<b>3,419</b>
<b>Financial instruments held for trading and derivatives used for hedging</b>		
Interest rate contracts	1,618	749
Foreign exchange	871	3,428
Equity contracts	168	(57)
Commodity contracts	15	22
	<b>2,672</b>	<b>4,142</b>
<b>Financial instruments designated at fair value through profit or loss</b>		
Financial assets designated at fair value through profit or loss	78	244
Financial liabilities designated at fair value through profit or loss	(73)	-
Foreign exchange differences	1,686	(967)
<b>Financial instruments at fair value through profit or loss and foreign exchange</b>	<b>4,363</b>	<b>3,419</b>

## 8. OTHER NET INCOME

(CZKm)	2016	2015
ICT services	642	-
Net operating leasing and rental income	81	151
Services provided to Československá obchodní banka, a.s (ČSOB SK) (excluding income from ICT services)	71	87
Net gain on disposal of non-current assets held-for-sale	8	58
Net gain on disposal of Held-to-maturity investments	2	4
Net gain on disposal of loans and receivables	1	381
Net loss on disposal of financial liabilities at amortised cost	-	(387)
Net (increase) / decrease in provisions for legal issues and other losses	(78)	6
Other	110	173
	<b>837</b>	<b>473</b>

After the reintegration of ICT function back to ČSOB (Note: 18), the Bank started from 1 January 2016, to provide information and communication services to other entities under common control. The related income is presented as part of Other net income under ICT services.

## 9. STAFF EXPENSES

(CZKm)	2016	2015
Wages and salaries	4,385	4,118
Salaries and other short-term benefits of top management	90	97
Social security charges	1,500	1,265
<i>of which pension security charges (obligatory)</i>	910	761
Pension (voluntary) and similar expenses	127	112
Additions of provision for Restructuring programme (Note: 27)	-	100
Other	132	97
	<b>6,234</b>	<b>5,789</b>

### Number of Bank personnel

The number (in full-time equivalents) of Bank personnel was 7,071 at 31 December 2016 (31 December 2015 7,099).

In 2015, information and communication services were reintegrated from KBC Group Czech Branch back to ČSOB (Note: 18). As a result, 750 employees of the KBC Group were transferred to the Bank as at 31 December 2015.

### Management bonus scheme

Included within Salaries and other short-term benefits of top management are salaries and remuneration of the Members of the Board of Directors. Salaries and remuneration of the Members of the Board of Directors, as well as the remuneration principles and structure, are subject to the approval of the Supervisory Board.

Following the change in legislation, a new bonus scheme for selective employees was launched in 2011. Half of the bonus is provided in a non-cash instrument Virtual investment certificate (VIC) as an equivalent of the 10-year government bond. The payment of half of the bonus (both cash and non-cash portion) is deferred for up to the next three years following the initial assignment of the benefit.

### Retirement benefits

The Bank provides its employees (including top management) with a voluntary defined contribution retirement scheme. Participating employees can contribute 1% or 2% of their salaries mainly to Transformovaný fond Stabilita ČSOB Penzijní společnosti, a.s., a member of the ČSOB Group or participation funds managed by ČSOB Penzijní společnost, a. s., a member of the ČSOB group and by other pension companies approved by the Ministry of Finance of the Czech Republic (MF CZ), with an additional contribution of the Bank of 2% or 3% of their salaries, respectively.

### Termination benefits

Employees dismissed by their employer according to Czech employment law are entitled to termination benefits equal to or less than three times the employee's monthly average salary. Additional termination benefits are granted to employees who were employed between 10-15 years (2 times the month's average salary), 15-20 years (2.5 times the month's average salary), 20-25 years (3 times the month's average salary), 25-30 years (4 times the month's average salary), 30-35 years (5 times the month's average salary) and over 35 years (6 times the month's average salary).

In the case of contract terminations, the members of the Board of Directors are entitled to receive an amount of 0 to 12 monthly salaries as termination benefits (according to conditions of individual contracts). In 2016 and 2015, no such compensation was paid.

## 10. GENERAL ADMINISTRATIVE EXPENSES

(CZKm)	2016	2015
Information technologies	2,172	3,244
Rental expenses on land and buildings – minimum lease payments	702	708
Marketing	528	463
Professional fees	449	394
Contribution to the Single Resolution Mechanism	435	-
Other building expenses	428	463
Communication	336	266
Retail service fees	200	237
Administration	188	153
Deposit insurance premium and contribution to the Securities Traders Guarantee Fund	158	944
Payment cards and electronic banking	152	142
Travel and transportation	146	144
Training	64	66
Car expenses	40	44
Insurance	36	36
Other	335	312
	<b>6,369</b>	<b>7,616</b>

Until 31 December 2015, the Bank was outsourcing information and communication services from KBC Group Czech Branch. As a result of the reintegration of the ICT function back to ČSOB Bank from 1 January 2016 (Note: 18), the structure of operating expenses has changed. Expenses related to ICT services are included under General administrative expenses fully in 2015, while in 2016, a portion of ICT related expenses is reported as part of Staff expenses and Depreciation and amortisation.

Information technology expenses include CZK Nil in 2016 (2015: CZK 1,943 m) representing minimum lease payments related to rental expenses of information technologies from KBC Group Czech Branch.

Based on the EU Directive and the related binding Delegated Act, banks in the EU are obliged to contribute to the Single Resolution Mechanism (SRM) from 2015. The rules were incorporated into the Czech law in December 2015 with the effective day 1 January 2016. The new law reflects the definition of SRM contributions and the changes in the deposit insurance premium calculation. In April 2016, the Bank obtained the final calculation of the contribution to the local resolution fund from the Czech National Bank amounting to CZK 435 m.

## 11. IMPAIRMENT LOSSES

(CZKm)	2016	2015
Impairment of loans and receivables (Notes: 17, 31, 38.2)	(551)	(525)
Provisions for loan commitments and guarantees (Notes: 27, 31)	53	(15)
Net impairment of investments in subsidiaries, associates and joint ventures (Notes: 18, 31)	151	(10)
Impairment of property and equipment (Notes: 20, 31)	(9)	-
Impairment of non-current assets held-for-sale (Notes: 22, 31)	-	(9)
Impairment of other assets (Note: 31)	(1)	-
Impairment of intangible assets (Notes: 20, 31)	(74)	-
	<b>(431)</b>	<b>(559)</b>

## 12. INCOME TAX

The components of income tax expense for the years ended 31 December 2016 and 2015 are as follows:

(CZKm)	2016	2015
Current tax expense	2,287	1,656
Net provisions for tax disputes	149	-
Previous year over accrual of current tax	(13)	(11)
Deferred tax benefit relating to the origination and reversal of temporary differences	(63)	(25)
	<b>2,360</b>	<b>1,620</b>

A reconciliation between the tax expense and the accounting profit multiplied by the domestic tax rate for the years ended 31 December 2016 and 2015 is as follows:

(CZKm)	2016	2015
Profit before taxation	17,904	16,401
Applicable tax rates	19%	19%
Taxation at applicable tax rates	3,402	3,116
Net provisions for tax disputes	149	-
Previous year over accrual of current tax	(13)	(11)
Tax effect of non-taxable income	(1,572)	(1,627)
Tax effect of non-deductible expenses	394	142
	<b>2,360</b>	<b>1,620</b>

The applicable tax rate for 2016 was 19% (2015: 19%).

Included in non-taxable income are tax-free interest income and dividend income.

Deferred income taxes are calculated on all temporary differences under the liability method using the income tax rate of 19%.

The movement on the deferred income tax account is as follows:

(CZKm)	2016	2015
<b>At 1 January</b>	<b>(870)</b>	<b>(1,106)</b>
Statement of income	63	25
Available-for-sale securities (Note: 29)		
Fair value remeasurement	61	(172)
Transfer to net profit	280	109
Cash-flow hedges (Note: 29)		
Fair value remeasurement	(21)	(22)
Transfer to net profit (Note: 19)	179	152
Other – acquisition of business under common control (Note: 18)	-	144
<b>At 31 December</b>	<b>(308)</b>	<b>(870)</b>

Deferred tax assets / (liability) are attributable to the following items:

(CZKm)	2016	2015
<b>Deferred tax assets / (liability)</b>		
Employee benefits	265	280
Temporary difference resulting from tax depreciation	180	231
Temporary difference resulting from tax depreciation related to acquisition of ICT function (Note: 18)	134	144
Legal claim	202	93
Allowances for credit losses	132	93
Provisions	97	99
Loans and receivables - bonds reclassified from Available-for-sale securities (Note: 16)	73	78
Impairment losses on financial investments	26	26
Impairment losses on tangible and intangible assets	17	2
Held-to-maturity investments - bonds reclassified from Available-for-sale securities (Note: 16)	(72)	(110)
Available-for-sale securities	(433)	(740)
Cash-flow hedges	(463)	(621)
Amortisation of goodwill	(478)	(442)
Other temporary differences	12	(3)
	<b>(308)</b>	<b>(870)</b>

The deferred tax benefit / (charge) in the statement of income comprises of the following temporary differences:

(CZKm)	2016	2015
Legal claim	109	15
Allowances for credit losses	39	7
Impairment losses on tangible and intangible assets	15	(17)
Provisions	(2)	15
Temporary difference resulting from tax depreciation related to acquisition of ICT function (Note: 18)	(10)	-
Employee benefits	(15)	(4)
Amortisation of goodwill	(36)	(36)
Temporary difference resulting from tax depreciation	(51)	43
Other temporary differences	14	2
	<b>63</b>	<b>25</b>

The Bank's management believes it is probable that the Bank will fully realise its gross deferred income tax assets based upon the Bank's current and expected future level of taxable profits and the expected offset from gross deferred income tax liabilities.

### 13. DIVIDENDS PAID AND RECEIVED

#### Dividends paid

Dividends paid are not accounted for until they have been ratified by a resolution of the sole shareholder on a profit distribution. The decision of a profit allocation for 2016 has not been taken before the date of issue of the financial statements.

Based on a sole shareholder decision from 22 April 2016, a dividend of CZK 50.49 per share was paid for 2015, representing a total dividend of CZK 14,781 m.

Based on a sole shareholder decision from 9 April 2015, a dividend of CZK 45.12 per share was paid for 2014, representing a total dividend of CZK 13,208 m.

#### Dividends received

The following table shows a dividend received by the companies for 2016 and 2015:

(CZKm)	2016	2015
Hypoteční banka, a.s.	2,990	3,078
ČSOB Leasing, a.s.	677	469
Českomoravská stavební spořitelna, a.s.	607	638
Patria Online, a.s.	321	300
ČSOB Factoring, a.s.	100	76
ČSOB Penzijní společnost, a. s., a member of the ČSOB group	72	-
Bankovní informační technologie, s.r.o.	45	44
ČSOB Asset Management, a.s., investment company	41	25
První certifikační autorita, a.s.	4	4
ČSOB Advisory, a.s.	2	671
CBCB - Czech Banking Credit Bureau, a.s.	2	2
ČSOB Pojišťovna, a. s., a member of the ČSOB holding	2	1
	<b>4,863</b>	<b>5,308</b>

### 14. CASH AND BALANCES WITH CENTRAL BANKS

(CZKm)	2016	2015
Cash (Note: 31)	9,074	9,516
Mandatory minimum reserves (Note: 38.2)	10,774	9,717
Other balances with central banks (Notes: 31, 38.2)	36,072	97,359
	<b>55,920</b>	<b>116,592</b>

The Czech National Bank (CNB) pays interest on the mandatory minimum reserve balances based on the official CNB two-week repo rate. The Bank is obliged to keep the balance of mandatory minimum reserve, however it is allowed to use the reserve for a liquidity management purposes during the month. Given that fact, mandatory minimum reserve is assessed to be a cash equivalent by the Bank.

Other balances with central banks contain overnight loans provided to central bank in the amount of CZK 33,900 m at 31 December 2016 (31 December 2015: CZK 94,900 m).



## 15. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

(CZKm)	2016	2015
<b>Financial assets held for trading</b>		
Loans and advances		
Money market placements	15	-
Debt instruments		
General government	4,527	13,270
Credit institutions	3,909	4,662
Corporate	247	1,198
Derivative contracts (Note: 19)		
Trading derivatives	12,179	10,860
Derivatives used as economic hedges	839	661
	<b>21,716</b>	<b>30,651</b>
<b>Financial assets designated at fair value through profit or loss</b>		
Debt instruments		
Credit institutions	3,485	3,491
	<b>3,485</b>	<b>3,491</b>
<b>Financial assets at fair value through profit or loss</b>	<b>25,201</b>	<b>34,142</b>

Included within Financial assets at fair value through profit or loss are debt securities of CZK 568 m (2015: CZK Nil) pledged as collateral in repo transactions or securities lending. Under the terms and conditions of the pledge in repo transaction or securities lending, the transferee has a right to sell or repledge the collateral.

Included in Financial assets designated at fair value through profit or loss are debt securities recorded at fair value to reduce the accounting mismatch that would otherwise arise from measuring these assets or recognising the gains and losses from them on a different basis.

## 16. FINANCIAL INVESTMENTS

(CZKm)	2016	2015
<b>Available-for-sale financial assets</b>		
Debt securities		
General government	39,586	38,944
Credit institutions	32,713	33,907
Corporate	426	234
Equity securities		
Corporate	342	1,304
	<b>73,067</b>	<b>74,389</b>
<b>Held-to-maturity investments</b>		
Debt securities		
General government	130,452	133,704
Credit institutions	1,394	1,395
Corporate	833	1,333
	<b>132,679</b>	<b>136,432</b>
<b>Financial investments</b>	<b>205,746</b>	<b>210,821</b>

Included within Financial investments are debt securities pledged as collateral in repo transactions in the amount of CZK 9,578 m (2015: CZK Nil) or securities lending in the amount of CZK 9,552 m (2015: CZK 3,489 m) and debt securities of CZK 12,601 m (2015: CZK 7,831 m) pledged as collateral of term deposits and financial guarantees. Under the terms and conditions of the pledge in repo transactions or securities lending, the transferee has a right to sell or repledge the collateral.

In June 2013, a part of the portfolio of debt sovereign bonds was transferred from Available-for-sale financial assets to the portfolio of Held-to-maturity investments in the fair value of CZK 14,513 m, as a result of the change of the Bank's intention to hold the bonds to maturity. Unrealised gains from the bonds in the amount of CZK 1,224 m at the date of the transfer remained a part of the Available-for-sale reserve and will be amortised in interest income over the remaining maturity of the bonds (2012: CZK 1,412 m).

In July and August 2013, a part of the portfolio of mortgage bonds was transferred from the Available-for-sale financial assets to the portfolio of Loans and receivables in the fair value of CZK 62,978 m, as a result of a change of the Bank's intention to hold the bonds to maturity. Unrealised losses from the bonds in the amount of CZK 463 m at the date of the transfer remained a part of the Available-for-sale reserve and will be amortised to the interest income over the remaining maturity of the bonds (2012: CZK 4,943 m).

Set out below is a comparison of the carrying amounts and fair values of the Bank's financial instruments that were reclassified from the Available-for-sale financial assets:

(CZKm)	2016		2015	
	Carrying value	Fair value	Carrying value	Fair value
<b>Financial assets</b>				
Held-to-maturity investments	8,552	9,396	13,446	14,445
Loans and receivables	61,586	58,220	62,017	58,045

The following table shows the total fair value gain or loss in Statement of comprehensive income that would have been recognised during 2016 if the Bank had not reclassified financial assets from Available-for-sale. This disclosure is provided for information purposes only; it does not reflect what has been recorded in the financial statements:

(CZKm)	Debt sovereign bonds	Mortgage bonds	Total
Net gain / (loss) on Available-for-sale assets (before tax)	(155)	606	451

The following table shows the total fair value gain or loss in Statement of comprehensive income that would have been recognised during 2015 after date of reclassification if the Bank had not reclassified financial assets from Available-for-sale. This disclosure is provided for information purposes only; it does not reflect what has been recorded in the financial statements:

(CZKm)	Debt sovereign bonds	Mortgage bonds	Total
Net gain / (loss) on Available-for-sale assets (before tax)	(55)	3,657	3,602

The following table shows the net profit or loss recorded on reclassified assets in 2016:

(CZKm)	Debt sovereign bonds	Mortgage bonds	Total
Interest income (before tax)	405	605	1,010

The following table shows the net profit or loss recorded on reclassified assets in 2015 after the date of reclassification:

(CZKm)	Debt sovereign bonds	Mortgage bonds	Total
Interest income (before tax)	446	780	1,226

The following table shows the expected undiscounted cash recoveries, as assessed at the date of reclassification and anticipated average effective interest rate (EIR) over the remaining life of the assets:

(CZKm)	Debt sovereign bonds	Mortgage bonds	Total
Expected undiscounted cash recoveries, as assessed at the date of reclassification	15,135	86,007	101,142
Anticipated average EIR over the remaining life of the assets	3.5%	2.0%	

As at 31 December 2015, the Bank reported a share in Visa Europe in the amount of CZK 1,288 m based on the model, which reflected the expected set up of the announced merger of Visa Inc. and Visa Europe Ltd. In June 2016, the takeover of Visa Europe Ltd. by Visa Inc. took place. According to the final approved structure of the transaction, the sales price is to be settled in three tranches: cash payment, transfer of preferred shares of Visa Inc. and further cash payment in 2019.

In June 2016, the Bank received a cash consideration in the amount of CZK 977 m as the first tranche.

The Bank acquired series C preferred shares of Visa Inc. as the second tranche. Accordingly, the Bank derecognised the original share in Visa Europe and recognised the share in Visa Inc. classified as Available-for-sale financial asset in the amount of CZK 251 m at 30 June 2016. The preferred shares of Visa Inc. can only be sold, with certain restrictions, to other holders of Visa Inc. preferred shares and will be fully converted to Visa Inc. listed shares after 12 years.

Furthermore, the Bank will receive a deferred cash payment of CZK 84 m as the third tranche, if the Bank keeps holding of the shares for at least 3 years past the merger.

As a result of the transaction, the Bank recognised a gain of CZK 1,295 m reported in the statement of income for 2016 as a Net realised gain on available-for-sale financial assets. The deferred cash payment of CZK 76 m will be amortized over the 3 years period.

The following table shows a reconciliation of the cumulative impairment losses on financial investments for 2015 and 2016:

(CZKm)	Available-for-sale financial assets Equity securities	Total
<b>At 1 January 2015</b>	<b>79</b>	<b>79</b>
Increase / (decrease)	-	-
<b>At 31 December 2015</b>	<b>79</b>	<b>79</b>
Utilisation	(29)	(29)
<b>At 31 December 2016</b>	<b>50</b>	<b>50</b>

## 17. LOANS AND RECEIVABLES

(CZKm)	2016	2015
<b>Analysed by category of borrower</b>		
Central banks	235,003	70,001
General government	6,188	8,673
Credit institutions	193,790	173,842
Other legal entities	226,929	216,569
Private individuals	43,425	39,561
Gross loans	705,335	508,646
Allowance for impairment losses	(6,595)	(6,978)
	<b>698,740</b>	<b>501,668</b>

Balances with central banks contain reverse repo transactions provided to central bank in the amount of CZK 235,003 m at 31 December 2016 (31 December 2015: CZK 70,001 m).

The following tables show a reconciliation of the allowances for impairment losses on loans and receivables for 2015 and 2016 by classes of financial instruments and by individual and collective impairment:

(CZKm)	General government	Credit institutions	Other legal entities	Private individuals	Total
<b>At 1 January 2015</b>	<b>7</b>	<b>13</b>	<b>5,423</b>	<b>1,541</b>	<b>6,984</b>
Net increase in allowances for credit losses (Note: 11)	(4)	(13)	476	66	525
Write-offs	-	-	(407)	(122)	(529)
Foreign currency translation	-	-	(4)	2	(2)
<b>At 31 December 2015</b>	<b>3</b>	<b>-</b>	<b>5,488</b>	<b>1,487</b>	<b>6,978</b>
Net increase in allowances for credit losses (Note: 11)	7	-	548	(4)	551
Write-offs	-	-	(808)	(126)	(934)
Foreign currency translation	-	-	(2)	2	-
<b>At 31 December 2016</b>	<b>10</b>	<b>-</b>	<b>5,226</b>	<b>1,359</b>	<b>6,595</b>

(CZKm)	Individual impairment	Collective impairment	Total
<b>At 1 January 2015</b>	<b>6,532</b>	<b>452</b>	<b>6,984</b>
Increase in allowances for credit losses (Note: 11)	1,503	146	1,649
Decrease in allowances for credit losses (Note: 11)	(1,018)	(106)	(1,124)
Write-offs	(529)	-	(529)
Foreign currency translation	(2)	-	(2)
<b>At 31 December 2015</b>	<b>6,486</b>	<b>492</b>	<b>6,978</b>
Increase in allowances for credit losses (Note: 11)	1,685	273	1,958
Decrease in allowances for credit losses (Note: 11)	(1,310)	(97)	(1,407)
Write-offs	(934)	-	(934)
<b>At 31 December 2016</b>	<b>5,927</b>	<b>668</b>	<b>6,595</b>

## 18. INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

Direct ownership of the Bank (%) in significant subsidiaries, associates and joint ventures was as follows:

Name	Abbreviation	2016		2015	
		(%)	Carrying amount	(%)	Carrying amount
<b>Subsidiaries</b>					
Bankovní informační technologie, s.r.o.	BANIT	100.00	60	100.00	60
Centrum Radlická a.s.	Centrum Radlická	100.00	709	100.00	709
ČSOB Advisory, a.s.	ČSOB Advisory	100.00	1,458	100.00	1,458
ČSOB Factoring, a.s.	ČSOB Factoring	100.00	1,145	100.00	1,095
ČSOB Leasing, a.s.	ČSOB Leasing	100.00	7,100	100.00	7,100
ČSOB Penzijní společnost, a. s., a member of the ČSOB group	ČSOB PS	100.00	1,475	100.00	1,267
	ČSOB Property fund	59.79	280	59.79	262
ČSOB Property fund, a.s.	fund	59.79	280	59.79	262
Hypoteční banka, a.s.	Hypoteční banka	100.00	31,127	100.00	30,776
Patria Online, a.s.	Patria Online	100.00	955	100.00	1,180
Radlice Rozvojová, a.s.	Radlice Rozvojová	100.00	366	100.00	271
<b>Joint venture</b>					
Českomoravská stavební spořitelna, a.s.	ČMSS	55.00	1,540	55.00	1,540
<b>Associate</b>					
ČSOB Asset Management, a.s., investment company	ČSOB AM	40.08	19	40.08	46
	ČSOB Pojišťovna, a. s., a member of the ČSOB holding	ČSOB Pojišťovna	0.24	9	0.24
			<b>46,243</b>		<b>45,773</b>

All companies are incorporated in the Czech Republic.

In March 2016, the Bank increased its investment in Radlice Rozvojová by CZK 55 m through an additional charge apart from the registered capital of the company.

In June 2016, a redemption of the other capital funds from ČSOB AM in the amount of CZK 27 m was processed.

Additional payments for the squeeze-out of minority interest in Hypoteční banka in 2016 resulted in an increase of the carrying amount of the interest of CZK 1 m.

In August 2016, the Bank increased its investment in ČSOB Factoring by CZK 50 m through an additional charge apart from the registered capital of the company.

In September 2016, the Bank increased its investment in Hypoteční banka by CZK 350 m through an additional charge apart from the registered capital of the company.

In December 2016, the Bank increased its investment in Radlice Rozvojová by CZK 40 m through an additional charge apart from the registered capital of the company.

In December 2016, the Bank decreased its investment in ČSOB PS by CZK 150 m through the redemption of other capital funds of the company.

On 19 December 2014, the Bank acquired of 100% shares and 100% voting rights of Patria Online, a.s., which has full control over Patria Finance, a.s. and Patria Corporate Finance, a.s. The acquisition cost was CZK 1,180 m and was based on an independent expert appraisal. Control over Patria Online, was transferred to the Bank on 1 January 2015.

In April 2015, based on the Sole shareholder decision, the Bank increased the share premium of Hypoteční banka by CZK 600 m.

In June 2015, the Bank increased its investment in ČSOB Leasing by CZK 1,200 m through an additional charge apart from the registered capital of the company.

In June 2015, a redemption of the other capital funds from ČSOB AM in the amount of CZK 27 m was processed.

In July 2015, the Bank increased its investment in ČSOB Factoring by CZK 120 m through an additional charge apart from the registered capital of the company.

In July 2015, a redemption of the other capital funds from ČSOB Advisory in the amount of CZK 400 m was processed.

In November 2015, the Bank increased its investment in ČSOB Leasing by CZK 1,000 m through an additional charge apart from the registered capital of the company.

In December 2015, based on the Sole shareholder decision, the Bank increased the share premium of Hypoteční banka by CZK 2,500 m.

Based on the Agreement on the exercise of voting rights, the Bank is entitled to a total of 40% of the voting rights in ČSOB Pojišťovna. Thus, ČSOB Pojišťovna is still assessed to be an associated company of the Bank.

Based on the Agreement on the exercise of voting rights, the Bank is entitled to a total of 95.67% of the voting rights in ČSOB Property fund.

Based on the company statutes, the Bank controls ČMSS jointly with the owner of the remaining 45%. Therefore, the entity is classified as a joint venture.

Ownership in other companies corresponds with the share of voting rights.

At 31 December 2015 and 2016, the Bank considered the value of interests in certain subsidiaries to be impaired.

In 2016 and 2015, with regard to the equity decrease and increased discounted projected cash flows the impairment of interests in ČSOB PS was reversed in the amount of CZK 358 m and CZK 250 m, respectively.

In 2016, the value of interests in Patria Online was impaired as a result of the distribution of retained earnings to ČSOB. The provision for an impairment loss of CZK 225 m, has been recognised.

In 2016, with regard to sale of a building controlled by ČSOB Property fund, the impairment of interests in ČSOB Property fund was reversed in the amount of CZK 18 m.

In December 2015, the value of interests in ČSOB Property fund was impaired as a result of a decrease in projected discounted cash flows. As a result, a provision for an impairment loss of CZK 10 m, has been recognised.

The Bank's management believes that there is no other indication of impairment in the value of its investments in subsidiaries, associates and joint ventures.

The following table shows a reconciliation of the impairment losses on investment in subsidiaries, associates and joint ventures for 2015 and 2016:

(CZK m)	ČSOB PS	ČSOB Property fund	Patria Online	Total
<b>At 1 January 2015</b>	<b>358</b>	<b>254</b>	-	<b>612</b>
Increase (Note: 11)	-	10	-	10
<b>At 31 December 2015</b>	<b>358</b>	<b>264</b>	-	<b>622</b>
Increase (Note: 11)	-	-	225	225
Decrease (Note: 11)	(358)	(18)	-	(376)
<b>At 31 December 2016</b>	-	<b>246</b>	<b>225</b>	<b>471</b>

In accordance with the Group strategy, information and communication services were reintegrated from KBC Group Czech Branch back to ČSOB in 2015 (Note: 36). An agreement to acquire a part of business was concluded between ČSOB and the KBC Group and became effective in December 2015. According to the agreement, selected activities and processes of the KBC Group Czech Branch, including a number of employees (Note: 9), assets and liabilities related to the ICT function, were acquired by the Bank on 31 December 2015. Such a transfer represented a purchase of a part of the business by the Bank. The sales price which represented net cash outflow from the Bank was determined on the basis of an independent expert appraisal and amounted to CZK 955 m. The difference between the purchase price of the business and carrying amount of the transferred assets and liabilities reached the amount of CZK 612 m and was recognised in the Bank's Equity.

The acquisition was included into the financial statements of the Bank using the pooling of interest method.

Set out below is an analysis of financial effect of the acquisition of the ICT function into the financial statements of the Bank as at 31 December 2015:

**Assets acquired and liabilities assumed**

(CZKm)	31.12.2015
<b>ASSETS</b>	
Deferred tax assets (Note: 12)	144
Property and equipment (Note: 20)	504
Goodwill and other intangible assets (Note: 21)	2,317
Other assets	135
<b>Total assets</b>	<b>3,100</b>
<b>LIABILITIES</b>	
Financial liabilities at amortised cost	2,738
Other liabilities	19
<b>Total liabilities</b>	<b>2,757</b>
<b>Total identifiable net assets</b>	<b>343</b>
Decrease of Retained earnings	612
<b>Cash consideration (Note: 26)</b>	<b>955</b>

The cash consideration was settled in February 2016. There was no contingent consideration resulting from the transaction. The balance of Financial liabilities at amortised cost as at 31 December 2015 included CZK 1,136 m of cash equivalents.



## 19. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative instruments are utilised by the Bank for trading and hedging purposes. Derivative instruments include swaps, forwards and option contracts. A swap agreement is a contract between two parties to exchange cash flows based on specified underlying notional amounts, assets and/or indices. Forward contracts are agreements to buy or sell a quantity of a financial instrument, index, currency or commodity at a predetermined future date and rate or price. An option contract is an agreement that conveys to the purchaser the right, but not the obligation, to buy or sell a quantity of a financial instrument, index, currency or commodity at a predetermined rate or price at a time or during a period in the future.

### Credit risk associated with derivative financial instruments

By using derivative instruments, the Bank is exposed to credit risk in the event of non-performance by counterparties in respect of derivative instruments. If a counterparty fails to perform, credit risk is equal to the positive fair value of the derivatives with that counterparty. When the fair value of a derivative is positive, the Bank bears the risk of loss; conversely, when the fair value of a derivative is negative, the counterparty bears the risk of loss (or credit risk). The Bank minimises credit risk through credit approvals, limits and monitoring procedures. Furthermore, the Bank obtains collateral where appropriate and uses bilateral master netting arrangements.

All derivatives are traded over-the-counter.

The maximum credit risk on the Bank's outstanding non-credit derivatives is measured as the cost of replacing their cash flows with positive fair value if the counterparties default, less the effects of bilateral netting arrangements and collateral held. The Bank's actual credit exposures are less than the positive fair value amounts shown in the derivative tables below as netting arrangements and collateral have not been considered.

### Trading derivatives

The Bank's trading activities primarily involve providing various derivative products to its customers and managing trading positions for its own account. Trading derivatives also include those derivatives which are used for asset and liability management (ALM) purposes to manage the interest rate position of the Banking Book (positions managed by ALM) and which do not meet the criteria of hedge accounting; still they are used as natural or economic hedges.

The contract or notional amounts and positive and negative fair values of the Bank's outstanding derivative trading positions as at 31 December 2016 and 2015 are set out in the table below. The contract or notional amounts represent the volume of outstanding transactions at a point in time; they do not represent the potential for gain or loss associated with the market risk or credit risk of such transactions.

### Trading positions

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Interest rate related contracts</b>						
Swaps	552,066	8,868	10,109	449,121	8,097	10,080
Forwards	16,700	2	-	39,592	6	-
Options	47,043	94	105	15,478	90	102
	<b>615,809</b>	<b>8,964</b>	<b>10,214</b>	<b>504,191</b>	<b>8,193</b>	<b>10,182</b>
<b>Foreign exchange contracts</b>						
Swaps / Forwards	161,563	1,182	452	140,985	852	453
Cross currency interest rate swaps	59,440	1,029	677	56,638	1,057	602
Options	74,236	571	569	32,877	158	163
	<b>295,239</b>	<b>2,782</b>	<b>1,698</b>	<b>230,500</b>	<b>2,067</b>	<b>1,218</b>
<b>Equity contracts</b>						
Swaps	5,360	118	92	3,710	13	85
Options	3,231	163	23	1,409	43	-
	<b>8,591</b>	<b>281</b>	<b>115</b>	<b>5,119</b>	<b>56</b>	<b>85</b>
<b>Commodity contracts</b>						
Swaps / Options	3,383	152	144	5,702	544	529
<b>Total trading derivatives (Notes: 15, 24)</b>	<b>923,022</b>	<b>12,179</b>	<b>12,171</b>	<b>745,512</b>	<b>10,860</b>	<b>12,014</b>

### Positions of ALM – economic hedges

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Interest rate related contracts</b>						
Swaps	148,337	463	217	90,589	299	232
<b>Foreign exchange contracts</b>						
Cross currency interest rate swaps	6,430	376	58	8,403	362	51
<b>Total derivatives used as economic hedges (Notes: 15, 24)</b>	<b>154,767</b>	<b>839</b>	<b>275</b>	<b>98,992</b>	<b>661</b>	<b>283</b>

## Hedging derivatives

The Bank's ALM function utilises derivative interest rate contracts in the management of the Bank's interest rate risk arising from non-trading or ALM activities, which are contained in the Bank's Banking Book. Interest rate risk arises when interest-sensitive assets have different maturities or repricing characteristics than the corresponding interest-sensitive liabilities. The Bank's objective for managing interest rate risk in the Banking Book is to reduce the structural interest rate risk within each currency and, thus, the volatility of net interest margins. Derivative strategies used to achieve this objective involve either swapping currency interest rate exposures or modifying repricing characteristics of certain interest-sensitive assets or liabilities so that the changes in interest rates do not have a significant adverse effect on the net interest margins and cash flows of the Banking Book. Bank policies to achieve these strategies currently require the use of both cash flow hedges and fair value hedges.

### Cash flow hedging derivatives

Most of the hedging derivatives are CZK single currency interest rate swaps. The Bank uses these instruments to hedge floating interest income from expected reverse repo operations with the Czech National Bank earning the 14-day interest repo rate. The hedging swap contracts are arranged to swap the floating interest rate 3M PRIBOR or 6M PRIBOR paid by the Bank and the fixed interest rate the Bank receives. The hedging construction is effective due to the strong correlation between the 14-day interest repo rate and 3M or 6M PRIBOR.

The Bank also uses single currency interest rate swaps

- to hedge the interest rate risk arising from changes in external interest rates on a group of client term deposits with contractual maturity varying from one week to six months and on a group of non-standard client current accounts (the variability in the interest paid on the client floating rate deposits is effectively hedged by the fixed rate payer/floating rate receiver swaps).
- to hedge the interest rate risk arising from changes in external interest rates on a group of non-retail client current accounts (the variability in the interest paid on the client deposits is effectively hedged by the fixed rate payer/floating rate receiver swaps).
- to convert floating-rate client loans to fixed rates.

Cross currency interest rate swaps are used to hedge currency risk resulting from interest income accrued on foreign currency investment debt securities. These fixed and floating interest earning securities are included in Available-for-sale financial assets and in Held-to-maturity investments of the Bank's statement of financial position.

The contract or notional amounts and positive and negative fair values of the Bank's outstanding cash flow hedging derivatives as at 31 December 2016 and 2015 are set out as follows:

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Cash flow hedges</b>						
Single currency interest rate swaps	106,722	5,150	2,476	107,058	6,245	2,915
Cross currency interest rate swaps	11,922	422	866	14,416	533	867
<b>Total hedging derivatives</b>	<b>118,644</b>	<b>5,572</b>	<b>3,342</b>	<b>121,474</b>	<b>6,778</b>	<b>3,782</b>

Net gains and losses on cash flow hedges reclassified to the statement of income are as follows:

(CZKm)	2016	2015
Interest income (Note: 29)	929	823
Net gains / (losses) from financial instruments at fair value through profit or loss (Note: 29)	12	(22)
Taxation (Note: 12)	<u>(179)</u>	<u>(152)</u>
<b>Net gains</b>	<b>762</b>	<b>649</b>

In 2016, a gain of CZK 3 m was recognised in the statement of income due to hedge ineffectiveness from cash flow hedges (2015: gain of CZK 15 m).

In 2016, the discontinuation of hedge accounting (due to sales of / impairment on underlying hedged bonds or retrospective hedge effectiveness test failure) resulted in a reclassification of the associated cumulative gains of CZK 10 m from equity to the statement of income (2015: losses CZK 38 m). The gains / losses are included in Net gains from financial instruments at fair value through profit or loss.

Since the cash flows from the hedging interest rate swaps are variable and difficult to predict, the Bank uses the remaining contractual maturity analysis of the hedging derivatives notional amounts instead of the expected future cash flows from the hedged items. As the objective of the hedging structure is to achieve fixed interest income, the information of the hedging swaps notional amounts remaining maturity is more relevant. Cash flows from hedged items are expected to occur in the same periods as the remaining maturity of cash flows from hedging derivatives.

The following table shows the notional amounts of hedging derivatives by remaining contractual maturity at 31 December 2016 and 2015:

(CZKm)	2016	2015
Less than 3 months	5,810	6,953
More than 3 months but not more than 6 months	9,492	2,395
More than 6 months but not more than 1 year	7,820	5,273
More than 1 year but not more than 2 years	20,978	23,112
More than 2 years but not more than 5 years	58,348	52,050
More than 5 years	<u>16,196</u>	<u>31,691</u>
	<b>118,644</b>	<b>121,474</b>

### Fair value hedging derivatives

Cross currency interest rate swaps are used to hedge both FX risks and interest rate risks arising from the movement in the fair value of foreign currency fixed rate bonds classified as Available-for-sale attributable to the changes in the FX rate and the risk-free (interest rate swap) yield curve. A fixed rate payer (foreign currency)/floating rate receiver (home currency) interest rate swap is expected to be a highly effective hedge.

Interest rate swaps are used by the Bank to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Available-for-sale attributable to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be highly effective hedge.

Fair value hedges for portfolios of retail non-maturity deposits have been used to hedge interest rate risk arising from changes in fair value of non-maturity retail deposits to changes in the risk-free yield curve. The portfolio consisting of the part of retail current and savings accounts was designated as a hedged item. The interest rate risk is effectively hedged by the single currency fixed rate receiver/floating rate payer swaps.

Fair value hedges for portfolios of fixed rate loans have been used to hedge interest rate risk arising from changes in the fair value of fixed rate loans to changes in the risk-free yield curve. The interest rate risk is effectively hedged by the single currency fixed rate payer/floating rate receiver swaps.

Fair value hedges for portfolios of fixed rate mortgage bonds classified as Available-for-sale have been used to hedge interest rate risk arising from changes in the fair value of fixed rate bonds to changes in the risk-free yield curve. The interest rate risk is effectively hedged by the single currency fixed rate payer/floating rate receiver swaps.

Interest rate swaps are used by the Bank to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Loans and receivables, i.e. private issues without active secondary market, to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be a highly effective hedge.

The contract or notional amounts and positive and negative fair values of the Bank's outstanding fair value hedging derivatives as at 31 December 2016 and 2015 are set out as follows:

(CZKm)	2016			2015		
	Notional amount	Fair value		Notional amount	Fair value	
		Positive	Negative		Positive	Negative
<b>Fair value hedges</b>						
<i>Single currency interest rate swaps</i>						
Fair value micro hedges	51,012	36	5,117	35,785	18	4,855
Fair value portfolio hedges	314,372	6,015	1,888	262,463	5,110	1,882
<i>Cross currency interest rate swaps</i>						
Fair value micro hedges	516	-	71	923	-	149
<b>Total hedging derivatives</b>	<b>365,900</b>	<b>6,051</b>	<b>7,076</b>	<b>299,171</b>	<b>5,128</b>	<b>6,886</b>

In 2016, the net losses in the amount of CZK 724 m (2015: CZK 318 m) realised on the hedged item attributable to the hedged interest rate risk is included in Net gains from financial instruments at fair value through profit or loss.

Net gains realised on the hedging contracts, which are included in Net gains from financial instruments at fair value through profit or loss, amounted to CZK 679 m (2015: CZK 216 m).

## 20. PROPERTY AND EQUIPMENT

(CZKm)	Land and buildings	IT equipment	Office equipment	Other	Construction in progress	Total
Cost at 1 January 2015	4,549	123	553	1,467	11	6,703
Depreciation and impairment at 1 January 2015	(2,520)	(123)	(429)	(1,080)	-	(4,152)
<b>Net book value at 1 January 2015</b>	<b>2,029</b>	<b>-</b>	<b>124</b>	<b>387</b>	<b>11</b>	<b>2,551</b>
Transfers	57	-	10	24	(91)	-
Additions	-	-	-	-	123	123
Disposals	(6)	-	(1)	(10)	-	(17)
Acquisition of business under common control (Note: 18)	-	414	-	21	69	504
Depreciation	(195)	-	(29)	(90)	-	(314)
Transfer to non-current assets held-for-sale	(62)	-	-	(20)	-	(82)
<b>Net book value at 31 December 2015</b>	<b>1,823</b>	<b>414</b>	<b>104</b>	<b>312</b>	<b>112</b>	<b>2,765</b>
of which						
Cost	4,392	511	549	1,334	112	6,898
Depreciation and impairment	(2,569)	(97)	(445)	(1,022)	-	(4,133)
<b>Net book value at 1 January 2016</b>	<b>1,823</b>	<b>414</b>	<b>104</b>	<b>312</b>	<b>112</b>	<b>2,765</b>
Transfers	149	340	19	71	(579)	-
Additions	-	-	-	-	770	770
Disposals	(23)	(1)	(3)	(8)	-	(35)
Depreciation	(187)	(177)	(29)	(92)	-	(485)
Impairment	(9)	-	-	-	-	(9)
<b>Net book value at 31 December 2016</b>	<b>1,753</b>	<b>576</b>	<b>91</b>	<b>283</b>	<b>303</b>	<b>3,006</b>
of which						
Cost	4,431	851	546	1,335	303	7,466
Depreciation and impairment	(2,678)	(275)	(455)	(1,052)	-	(4,460)

In 2015, assets related to the ICT function were acquired by the Bank as a result of the reintegration of ICT services back to ČSOB (Note: 18). They are reported under Acquisition of business under common control.

Property and equipment are assessed as non-current assets.

## 21. GOODWILL AND OTHER INTANGIBLE ASSETS

(CZK m)	Goodwill	Software	Other intangible assets	Construction in progress	Total
Cost at 1 January 2015	2,752	2,347	726	9	5,834
Amortisation and impairment at 1 January 2015	(63)	(2,338)	(706)	-	(3,107)
<b>Net book value at 1 January 2015</b>	<b>2,689</b>	<b>9</b>	<b>20</b>	<b>9</b>	<b>2,727</b>
Transfers	-	3	29	(32)	-
Additions	-	-	-	26	26
Acquisition of business under common control (Note: 18)	-	1,776	-	541	2,317
Amortisation	-	(3)	(8)	-	(11)
<b>Net book value at 31 December 2015</b>	<b>2,689</b>	<b>1,785</b>	<b>41</b>	<b>544</b>	<b>5,059</b>
of which					
Cost	2,752	4,124	754	544	8,174
Amortisation and impairment	(63)	(2,339)	(713)	-	(3,115)

(CZK m)	Goodwill	Software	Other intangible assets	Construction in progress	Total
Cost at 1 January 2016	2,752	4,124	754	544	8,174
Amortisation and impairment at 1 January 2016	(63)	(2,339)	(713)	-	(3,115)
<b>Net book value at 1 January 2016</b>	<b>2,689</b>	<b>1,785</b>	<b>41</b>	<b>544</b>	<b>5,059</b>
Transfers	-	59	35	(94)	-
Additions	-	-	-	738	738
Disposals	-	(12)	-	-	(12)
Amortisation	-	(450)	(12)	-	(462)
Impairment	-	(14)	-	(60)	(74)
<b>Net book value at 31 December 2016</b>	<b>2,689</b>	<b>1,368</b>	<b>64</b>	<b>1,128</b>	<b>5,249</b>
of which					
Cost	2,752	4,394	530	1,188	8,864
Amortisation and impairment	(63)	(3,026)	(466)	(60)	(3,615)

In 2015, assets related to the ICT function were acquired by the Bank as a result of the reintegration of ICT services back to ČSOB (Note: 18). They are reported under Acquisition of business under common control.

Included in Construction in progress is internally developed software in the net amount of CZK 1,116 m as at 31 December 2016 (31 December 2015: CZK 529 m).

Goodwill and other intangible assets are assessed as non-current assets.

Goodwill has been allocated to the Retail segment and SME clients, representing a cash-generating unit (CGU). The recoverable amount for the Retail segment and SME clients was determined based on the value-in-use methodology. The calculation uses cash flow projections from business plans for the forthcoming four years which are then extrapolated for a five further years using the expected average growth rate of 3%; after that a terminal value is applied.

Cash flows in the Retail segment and SME clients are based on the net profit generated by the CGU above the required capital and a terminal value of the business. For the calculation of the terminal value a sustainable discount rate of 10.1% in 2016 (2015: 9.8%) and no long term growth rates were used in 2016 and 2015.



The value in use is particularly sensitive to a number of key assumptions:

- The growth rate in forecasted cash flows beyond the terminal year of the budget. The Bank has a conservative approach when calculating the terminal value, which implies that no growth rate for Retail segment and SME clients has been used for extrapolation purposes beyond the budget period.
- The risk discount rate. For Retail segment and SME clients an average risk discount rate of 10.0% has been applied (2015: 9.8%). This reflects a risk-free rate in the Eurozone, long-term inflation in the Czech market and in the Eurozone, the credit default swap spread for the Czech Republic relative to the Eurozone, an average 'beta' factor for relative market risk, including the market risk premium.

The key assumptions described above may change as economic and market conditions change.

The outcome of the impairment assessment was that it is considered unlikely that goodwill in respect of the Retail segment and SME clients would be impaired given that the value-in-use is significantly higher than the carrying value of goodwill.

The management believes that reasonable potential changes in the key assumptions on which the recoverable amount is based would not cause it to fall below the carrying amount.

## 22. NON-CURRENT ASSETS HELD-FOR-SALE

(CZKm)	Land and buildings	Other	Total
<b>Net book value at 1 January 2015</b>	<b>491</b>	-	<b>491</b>
Transfer from Property and equipment	62	20	82
Additions	38	-	38
Disposal	(516)	(20)	(536)
Impairment (Note: 11)	(9)	-	(9)
<b>Net book value at 31 December 2015</b>	<b>66</b>	-	<b>66</b>
of which			
Cost	75	-	75
Impairment	(9)	-	(9)
(CZKm)	Land and buildings	Other	Total
<b>Net book value at 1 January 2016</b>	<b>66</b>	-	<b>66</b>
Additions	1	-	1
Disposal	(32)	-	(32)
<b>Net book value at 31 December 2016</b>	<b>35</b>	-	<b>35</b>
of which			
Cost	44	-	44
Impairment	(9)	-	(9)

Movements disclosed in Transfer from Property and equipment represent buildings and other property which were decided to be sold. The buildings were measured at the lower of their carrying amount and fair value less costs to sell. The fair value of the buildings was calculated based on indicative market prices.

The impairment losses resulting from the decreased recoverable amount of the buildings were caused by a decrease of expected future cash-flows less costs to sell.

**23. OTHER ASSETS**

(CZKm)	2016	2015
Other debtors, net of provisions (Notes: 30, 32, 35, 38.2)	675	682
Prepaid charges	229	233
Accrued income (Notes: 30, 32, 35, 38.2)	117	216
VAT and other tax receivables	9	5
	<b>1,030</b>	<b>1,136</b>

Other assets are assessed as current assets.

**24. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS**

(CZKm)	2016	2015
<b>Financial liabilities held for trading</b>		
Short positions	13,025	6,147
Derivative contracts (Note: 19)		
Trading derivatives	12,171	12,014
Derivatives used as economic hedges	275	283
Term deposits	3,184	1,580
Bonds and investment certificates issued	11,413	10,061
	<b>40,068</b>	<b>30,085</b>
<b>Financial liabilities designated at fair value through profit or loss</b>		
Investment certificates	1,620	-
	<b>1,620</b>	-
<b>Financial liabilities at fair value through profit or loss</b>	<b>41,688</b>	<b>30,085</b>

The amount that the Bank would contractually be required to pay at the maturity of the financial liabilities designated at fair value through profit or loss is CZK 73 m less than the carrying amount at 31 December 2016 (31 December 2015: CZK Nil).

The changes in the fair value of the Financial liabilities designated at fair value through profit or loss attributable to changes in own credit risk were not significant.

Included in Financial liabilities designated at fair value through profit or loss are debt instruments containing an embedded derivative.

## 25. FINANCIAL LIABILITIES AT AMORTISED COST

(CZKm)	2016	2015
<b>Deposits received from credit institutions</b>		
Current accounts and overnight deposits	9,114	10,838
Term deposits	18,844	19,465
Repo transactions	9,452	-
	<b>37,410</b>	<b>30,303</b>
<b>Deposits received from other than credit institutions</b>		
Current accounts and overnight deposits	441,984	389,407
Term deposits	8,299	11,083
Savings deposits	214,689	213,355
Other deposits	9,107	7,073
	<b>674,079</b>	<b>620,918</b>
<b>Debt securities in issue</b>		
Bonds and investment certificates issued	501	10
Promissory notes	197,644	145,870
	<b>198,145</b>	<b>145,880</b>
<b>Financial liabilities at amortised cost</b>	<b>909,634</b>	<b>797,101</b>

## 26. OTHER LIABILITIES

(CZKm)	2016	2015
Accrued charges (Notes: 30, 32, 35, 38.3)	1,551	2,139
Payables to employees including social security charges (Notes: 30, 32, 35, 38.3)	1,889	1,719
Other creditors (Notes: 30, 32, 35, 38.3)	374	563
Income received in advance	114	138
VAT and other tax payables	87	81
	<b>4,015</b>	<b>4,640</b>

As at 31 December 2015, the balance of Accrued charges included unsettled consideration in respect of the acquisition of ICT function in the amount of CZK 955 m (Note: 18).

Other liabilities are assessed as current liabilities.

## 27. PROVISIONS

	Pending legal issues and other losses	Restructuring	Contractual engagements	Loan commitments and guarantees (Note: 33)	Total
(CZKm)					
<b>At 1 January 2015</b>	<b>318</b>	<b>38</b>	<b>58</b>	<b>272</b>	<b>686</b>
Additions	22	100	-	95	217
Amounts utilised	(253)	(38)	(16)	-	(307)
Unused amounts reversed	(6)	-	-	(80)	(86)
Discount amortisation (Note: 5)	-	-	3	-	3
Foreign currency translation	-	-	-	(2)	(2)
<b>At 31 December 2015</b>	<b>81</b>	<b>100</b>	<b>45</b>	<b>285</b>	<b>511</b>
Additions	331	-	27	141	499
Amounts utilised	(54)	(51)	(35)	-	(140)
Unused amounts reversed	(17)	-	(8)	(194)	(219)
Discount amortisation (Note: 5)	-	-	3	-	3
<b>At 31 December 2016</b>	<b>341</b>	<b>49</b>	<b>32</b>	<b>232</b>	<b>654</b>

### *Restructuring*

During 2012, the Bank started a restructuring programme to reduce the total number of personnel, resulting in the creation of a provision of CZK 191 m. The Bank used the remaining provision of CZK 38 m to cover the costs related to reductions in the number of personnel in 2015.

During 2015, the Bank started a new restructuring programme, resulting in the creation of a provision of CZK 100 m (Note: 9). In the framework of this restructuring programme the total number of personnel should be reduced in 2017.

### *Pending legal issues and other losses*

Provisions for legal issues and other losses represent an obligation to cover potential risks resulting from litigation, where the Bank is the defendant.

The Bank is involved in a number of ongoing legal disputes, the resolution of which may have an adverse financial impact on the Bank. Based upon historical experience and expert reports, the Bank assesses the developments in these cases, and the likelihood and the amount of potential financial losses which are appropriately provided for.

The Bank's policy is to create a provision, where the possibility of an outflow of resources embodying economic benefits to settle the obligation is more than 50%. In such cases the Bank creates a provision in the full amount to cover the possible cost in the event of loss.

In 2016, the Bank had a provision for pending legal issues and other losses in the total amount of CZK 341 m. It is expected that the majority of the costs will be incurred in the next 3 years.

On a quarterly basis, the Bank monitors the status of all cases and makes a decision as to whether to create, utilise or reverse any provision.

The Bank does not disclose the details underlying the disputes as the disclosure may have an impact on the outcome of the disputes and may seriously harm the Bank's interests.

### *Contractual engagements*

A number of leasehold property arrangements for which, on a net basis, the unavoidable contractual rental costs exceeds normal market rental conditions exists in the Bank. This provision represents the present value of the future net rental losses that will arise. It is expected that the majority of costs will be incurred over the next 3 years.

## 28. SHARE CAPITAL AND OTHER RESERVES

As at 31 December 2016, the total authorised share capital was CZK 5,855 m (31 December 2015: CZK 5,855 m) and comprised of 292,750,002 ordinary shares with a nominal value of CZK 20 each (31 December 2015: 292,750,002 ordinary shares with a nominal value of CZK 20 each) and is fully paid up.

Based on the resolution of the sole shareholder dated 16 December 2015, ČSOB issued one ordinary share with a nominal value of CZK 20 and with a share premium of CZK 5,419,999,980 (evidenced by an entry in the Register of Companies dated 21 December 2015).

No Treasury shares were held by the Bank at 31 December 2016 and 2015.

On 31 December 2016, the Bank was directly controlled by KBC Bank whose ownership interest in ČSOB was 100% (31 December 2015: 100%). On the same date, KBC Bank was controlled by the KBC Group and, therefore, KBC Group was the company indirectly exercising ultimate control over the Bank.

### Other reserves

The following table shows movements of Other reserves in 2016 and 2015:

(CZK m)	Available- for-sale reserve	Cash flow hedge reserve	Total
<b>At 1 January 2015</b>	<b>3,027</b>	<b>3,201</b>	<b>6,228</b>
Other comprehensive income (Note: 29)	269	(555)	(286)
<b>At 31 December 2015</b>	<b>3,296</b>	<b>2,646</b>	<b>5,942</b>
Other comprehensive income (Note: 29)	(1,452)	(673)	(2,125)
<b>At 31 December 2016</b>	<b>1,844</b>	<b>1,973</b>	<b>3,817</b>

## 29. COMPONENTS OF OTHER COMPREHENSIVE INCOME

(CZK m)	2016	2015
<b>Cash flow hedges</b>		
Net unrealised gains on cash flow hedges	110	116
Net gains on cash flow hedges reclassified to the statement of income (Note: 19)	(941)	(801)
Tax effect relating to cash flow hedges (Note: 12)	158	130
	(673)	(555)
<b>Available-for-sale financial assets</b>		
Net unrealised (losses) / gains on available-for-sale financial investments	(322)	903
Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal	(1,295)	(334)
Net realised gains on available-for-sale financial investments amortised to the statement of income on reclassified assets (Note: 16)	(176)	(237)
Tax effect relating to available-for-sale financial investments (Note: 12)	341	(63)
	(1,452)	269
<b>Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods</b>	<b>(2,125)</b>	<b>(286)</b>

In 2016, net gain of CZK 1,295 m resulting from the transaction of merger Visa Inc. and Visa Europe Ltd. is reported as part of Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal.

## 30. FAIR VALUE OF FINANCIAL INSTRUMENTS

### Financial assets and liabilities at fair value

The Bank's accounting policy on fair value measurements is discussed in the Accounting policies (Note 2.4 (4)).

Financial assets and liabilities at fair value (available-for-sale, held for trading, designated at fair value through profit or loss) are valued as follows:

- **Level 1**  
If available, published price quotations in active markets are used to determine the fair value of financial assets or financial liabilities. Revaluation is obtained using prices of an identical asset or liability, which means that no model is involved in the process of a revaluation. Financial instruments valued on this basis include spot foreign exchange contracts and listed shares and bonds.  
  
Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques.
- **Level 2**  
Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observed from the market.  
  
Financial instruments valued on this basis include forward interest rate, foreign exchange and commodity contracts, mortgage bonds, money market loans and deposits.
- **Level 3**  
Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.  
  
Financial instruments for which the parameters are not observable include unlisted shares, a part of the portfolio of trading derivatives, a part of the portfolio of mortgage bonds and selected listed but not traded bonds.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to determine a fair value that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Bank uses widely recognised valuation models for determining the fair value of common and less complex financial instruments like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter derivatives like interest rate swaps. The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Bank uses proprietary valuation models, which are usually developed from recognised valuation models. Some or all of the significant inputs into these models

may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Examples of instruments involving significant unobservable inputs include certain over-the-counter structured derivatives, certain loans and securities for which there is no active market. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, the determination of expected future cash flows on the financial instrument being valued, the determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The Valuation policy is subject to approval of the ČSOB Risk and Capital Oversight Committee and KBC Group Valuation Committee. The process for the approval of any new product consist also of an assessment of the valuation of the product and the eventual new valuation model for the product has to be approved before the product is endorsed or approval of the model is a blocking condition for the product implementation. The New and Active Product Process also requires a regular review of all products and the assessment of valuation quality is an important part of the review. Any valuation model, which uses not directly observable inputs, is subject to the Parameter review policy. The policy requires quarterly assessment of all parameters correctness. The Bank currently checks the valuation of all bonds quarterly.

The Bank also monitors the quality of asset valuations on a daily basis. If an asset quote quality does not meet the required criteria for Level 1 or level 2 the asset is transferred to Level 3 and vice versa. The monitoring process evaluates among others the frequency of quote updates.

The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

(CZK m)	Level 1	Level 2	Level 3	Total
<b>Financial assets recorded at fair value</b>				
Financial assets held for trading				
Loans and advances	-	15	-	15
Debt instruments	3,075	794	4,814	8,683
Derivative contracts	-	12,918	100	13,018
Financial assets designated at fair value through profit or loss				
Debt instruments	-	-	3,485	3,485
Available-for-sale financial assets				
Debt securities	38,834	21,318	12,573	72,725
Equity securities	-	-	342	342
Fair value adjustments of the hedged items in portfolio hedge	-	797	-	797
Derivatives used for hedging	-	11,623	-	11,623
<b>Financial liabilities recorded at fair value</b>				
Financial liabilities held for trading				
Short positions	13,025	-	-	13,025
Derivative contracts	-	12,304	142	12,446
Term deposits	-	3,184	-	3,184
Bonds issued	-	11,413	-	11,413
Financial liabilities designated at fair value				
Investment certificates	-	1,620	-	1,620
Fair value adjustments of the hedged items in portfolio hedge	-	4,796	-	4,796
Derivatives used for hedging	-	10,418	-	10,418



The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2015:

(CZKm)	Level 1	Level 2	Level 3	Total
<b>Financial assets recorded at fair value</b>				
Financial assets held for trading				
Debt instruments	6,749	6,667	5,714	19,130
Derivative contracts	-	11,432	89	11,521
Financial assets designated at fair value through profit or loss				
Debt instruments	-	-	3,491	3,491
Available-for-sale financial assets				
Debt securities	38,051	30,646	4,388	73,085
Equity securities	-	-	1,304	1,304
Fair value adjustments of the hedged items in portfolio hedge	-	866	-	866
Derivatives used for hedging	-	11,906	-	11,906
<b>Financial liabilities recorded at fair value</b>				
Financial liabilities held for trading				
Short positions	6,147	-	-	6,147
Derivative contracts	-	12,135	162	12,297
Term deposits	-	1,580	-	1,580
Bonds issued	-	10,061	-	10,061
Fair value adjustments of the hedged items in portfolio hedge	-	4,062	-	4,062
Derivatives used for hedging	-	10,668	-	10,668

Yield curve used in the mortgage bonds valuation model for discounting future cash flows curves is constructed from IRS rates and respective credit spreads. The credit spreads are derived from available market quotes of mortgage bonds, governments bonds and IRS rates.

The spreads for the first five years of maturity were exclusively derived from market observable quotes of mortgage bonds until the end of 2015. Therefore mortgage bonds with a maturity of up to five years were included in Level 2. The spread for the rest of the curve was derived from observed mortgage bond spread at 5 and 10 years and the slope of the Czech government yield curve. The management considered this a significant market unobservable input, and as a consequence, the mortgage bonds with a maturity of longer than 5 years were reported as part of Level 3 in 2015.

In 2016, some changes were observed on the mortgage bond market. As a consequence of these changes, only the spreads for maturities up to one year were exclusively derived from the market observable quotes of mortgage bonds. Therefore only mortgage bonds with a maturity up to one year are included in Level 2. The spread for the rest of the curve are derived from observed mortgage bond spread at one year and slope of the Czech government yield curve. The management considers this a significant market unobservable input, and as a consequence, the mortgage bonds with a maturity of longer than one year were transferred to Level 3 in 2016.

The spread according to bond maturity was 75 bps (7-year) to 142 bps (above 25-year) in 2015 and 96 bps (7-year) to 182 bps (above 30-year) in 2016.

In 2015, a model for the valuation of bonds issued by Česká Exportní Banka (ČEB) changed. Yield curves (different for floating and fix bonds) used in the ČEB bonds valuation model for discounting future cash flows are constructed from IRS rates and respective credit spreads. The credit spreads are derived from the quotes of the most liquid bonds issued by ČEB and IRS rates. The management considers this a significant market unobservable input and, as a consequence, the bonds issued by ČEB remained classified as Level 3.

The implementation of the new ČEB valuation model, which has been used since June 2015, resulted in unrealised gains of CZK 245 m recorded in Net gains from financial instruments at fair value through profit or loss and unrealised gains of CZK 75 m recorded in Available-for-sale reserve in 2015. There were no changes of the ČEB valuation model in 2016. The spreads are regularly updated, at the latest quarterly. The spread according to bond maturity was 16 bps (1-year) to 195 bps (10-year) for fixed bonds and 12 bps (1-year) to 53 bps (10-year) for floating bonds after last review in December 2016 (2015: 19 bps (1-year) to 159 bps (10-year) for fixed bonds and 28 bps (1-year) to 47 bps (10-year)).

Following the declared intention of VISA Inc. to acquire VISA Europe Limited, the Bank changed a model for the valuation of its share in VISA Europe Limited in 2015. The model reflected the expected set up of the transaction. The model calculated the fair value of the Bank's share in VISA Europe Limited combining an upfront cash consideration, an upfront share consideration and an earn-out, which would be payable in cash four years past the merger. The value of the share was derived from the report of VISA Europe Limited. The implementation of this model resulted in unrealised gains of CZK 861 m recorded in Available-for-sale reserve in 2015.

In June 2016, the merger took place and the original Bank's share in VISA Europe and the respective unrealised gain of CZK 1,153 m retained in equity were derecognised. The new share in VISA Inc. classified as Available-for-sale financial asset in the amount of CZK 251 m is subject to fair value measurement based on the quoted price of VISA Inc.

All transfers of financial instruments among the levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

### Movements in Level 3 financial instruments measured at fair value

The following table shows the reconciliation of the opening and closing amount of financial assets which are recorded at fair value using valuation techniques based on non-market observable inputs:

(CZKm)	Financial assets held for trading		Financial assets designated at fair value through profit or loss	Available-for-sale financial assets		Total
	Trading derivatives	Debt securities	Debt securities	Debt securities	Equity securities	
<b>At 1 January 2015</b>	-	<b>5,560</b>	<b>3,378</b>	<b>3,157</b>	<b>443</b>	<b>12,538</b>
Total gains / (losses) recorded in profit or loss	89	371	113	(79)	-	494
Total gains recorded in other comprehensive income	-	-	-	16	861	877
Transfers into Level 3	-	155	-	-	-	155
Transfers out of Level 3	-	(153)	-	-	-	(153)
Purchases	-	2,187	-	1,294	-	3,481
Settlement	-	(512)	-	-	-	(512)
Sales	-	(1,894)	-	-	-	(1,894)
<b>At 31 December 2015</b>	<b>89</b>	<b>5,714</b>	<b>3,491</b>	<b>4,388</b>	<b>1,304</b>	<b>14,986</b>
Total gains recorded in profit or loss related to assets held at the end of the reporting period	89	359	112	-	-	<b>560</b>
<b>At 1 January 2016</b>	<b>89</b>	<b>5,714</b>	<b>3,491</b>	<b>4,388</b>	<b>1,304</b>	<b>14,986</b>
Total gains / (losses) recorded in profit or loss	199	61	(6)	(1)	-	253
Total gains recorded in other comprehensive income	-	-	-	73	28	101
Transfers into Level 3	-	1,470	-	8,147	-	9,617
Transfers out of Level 3	-	(814)	-	-	-	(814)
Purchases	-	2,363	-	-	305	2,668
Settlement	(188)	(991)	-	-	-	(1,179)
Sales	-	(2,989)	-	(34)	(1,295)	(4,318)
<b>At 31 December 2016</b>	<b>100</b>	<b>4,814</b>	<b>3,485</b>	<b>12,573</b>	<b>342</b>	<b>21,314</b>
Total gains recorded in profit or loss related to assets held at the end of the reporting period	199	79	(6)	(1)	-	<b>210</b>

Total gains recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss, Net realised gains on available-for-sale financial assets and Impairment losses of the statement of income.

The following table shows the reconciliation of the opening and closing amount of financial liabilities which are recorded at fair value using valuation techniques based on non-market observable inputs:

(CZKm)	Financial liabilities held for trading Trading derivatives
<b>At 1 January 2015</b>	-
Total losses recorded in profit or loss	162
<b>At 31 December 2015</b>	<b>162</b>
Total losses recorded in profit or loss related to liabilities held at the end of the reporting period	162
<b>At 1 January 2016</b>	<b>162</b>
Total losses recorded in profit or loss	178
Settlement	(198)
<b>At 31 December 2016</b>	<b>142</b>
Total losses recorded in profit or loss related to liabilities held at the end of the reporting period	178

Total losses recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss of the statement of income.

#### Impact on fair value of Level 3 financial instruments measured at fair value of changes to key assumptions

Management considers the value of the credit spread included in the discount factor applied on estimated future cash flows from the mortgage bonds in periods after the fifth year (applicable in 2015) and in periods after the first year (applicable in 2016) from the balance sheet date as a key assumption not derived from observable market inputs, which is influencing the fair value of Level 3 financial instruments.

As at 31 December 2016, an increase / (decrease) of the credit spread by 50 basis points would (decrease) / increase the fair value of the mortgage bonds and bonds issued by ČEB included in Level 3 by CZK 267 m and CZK 84 m, respectively (2015: CZK 98 m and CZK 91 m, respectively). Such a change in the credit spread is based on the variability of mortgage bond and ČEB bond quotes that were observed by the management on the market.

Management believes that reasonably possible changes in other non-observable market inputs in the valuation models used would not have a material impact on the estimated fair values.

#### Transfers between Level 1 and 2 of the fair value hierarchy for financial instruments

The following table shows transfers between a group of financial instruments with a market quoted price and those for which the fair value is calculated using valuation techniques based on market observable inputs:

(CZKm)	Transfers from Level 1 to Level 2		Transfers from Level 2 to Level 1	
	2016	2015	2016	2015
<b>Financial assets</b>				
Financial assets held for trading				
Debt instruments	-	3	-	-

**Financial assets and liabilities not carried at fair value**

Set out below is a comparison of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the financial statements:

(CZKm)	2016		2015	
	Carrying value	Fair value	Carrying value	Fair value
<b>Financial assets</b>				
Cash and balances with central banks	55,920	55,920	116,592	116,592
Loans and receivables	698,740	701,012	501,668	504,024
Held-to-maturity investments	132,679	151,699	136,432	158,636
Other assets (Note: 23)	792	792	898	898
<b>Financial liabilities</b>				
Financial liabilities at amortised cost	909,634	913,934	797,101	800,255
Other liabilities (Note: 26)	3,814	3,814	4,421	4,421

The following table shows an analysis of financial instruments for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

(CZKm)	Level 1	Level 2	Level 3	Total
<b>Financial assets for which fair values are disclosed</b>				
Cash and balances with central banks	9,074	46,846	-	55,920
Loans and receivables	-	251,529	449,483	701,012
Held-to-maturity investments	149,288	-	2,411	151,699
Other assets (Note: 23)	-	792	-	792

**Financial liabilities for which fair values are disclosed**

Financial liabilities at amortised cost	-	885,496	28,438	913,934
Other liabilities (Note: 26)	-	3,814	-	3,814

The following table shows an analysis of financial instruments for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2015:

(CZKm)	Level 1	Level 2	Level 3	Total
<b>Financial assets for which fair values are disclosed</b>				
Cash and balances with central banks	9,516	107,076	-	116,592
Loans and receivables	-	165,568	338,456	504,024
Held-to-maturity investments	153,599	570	4,467	158,636
Other assets (Note: 23)	-	898	-	898

**Financial liabilities for which fair values are disclosed**

Financial liabilities at amortised cost	-	773,600	26,655	800,255
Other liabilities (Note: 26)	-	4,421	-	4,421

The following methods and assumptions were applied in estimating the fair values of the Bank's financial assets and liabilities:

**Held-to-maturity investments**

Fair values for held-to-maturity securities are based on quoted market prices, where available. Such quotes are obtained from relevant exchanges, if exchange activity for the particular security is considered sufficiently liquid, or from reference rates averaging market maker quotes. If quoted market prices are not available, fair values are estimated from quoted market prices of comparable instruments or using the valuation model using discounted future cash flows.

**Loans and receivables to credit institutions and balances with central banks**

The carrying values of current account balances are equal to their fair values. The fair values of term placements with credit institutions and central banks are estimated by discounting their future cash flows using current interbank market rates, including the respective credit spread derived from the Bank's own experience of probability of default and loss given default. A majority of the loans reprice within relatively short time periods, therefore, it is assumed that their carrying values approximate their fair values.

**Loans and receivables to other than credit institutions**

A substantial majority of the loans to customers reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values. The fair values of fixed-rate loans to customers are estimated by discounting their future cash flows using current market rates including the respective credit spread derived from the Bank's own experience of probability of default and loss given default. Fair value incorporates expected future losses, while amortised cost and related impairment include only incurred losses at the end of the accounting period.

**Deposits received from credit institutions and subordinated liabilities**

The carrying values of current account balances are equal to their fair values. For other amounts due to credit institutions with equal to or less than one year remaining maturity, it is assumed that their carrying values approximate their fair values. The fair values of other amounts due to credit institutions are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spread.

**Deposits received from other than credit institutions**

The fair values of current accounts and term deposits, with equal to or less than one year remaining to maturity, approximate their carrying values. The fair values of other term deposits are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spreads.

**Debt securities in issue**

The fair values of bonds issued are estimated by discounting their future cash flows using Czech government bond rates adjusted by credit spread derived from market observable transactions with respective or comparable bonds. The carrying values of promissory notes and certificates of deposit approximate their fair values.

**Other assets and other liabilities**

A majority of other assets and liabilities have a remaining maturity equal to or less than one year or reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values.

### 31. ADDITIONAL CASH FLOW INFORMATION

#### Analysis of the balances of cash and cash equivalents as shown in the statement of financial position

(CZKm)	2016	2015
Cash and balances with central banks	55,920	116,592
Loans and advances to credit institutions and central banks	238,695	74,901
Financial liabilities at amortised cost to credit institutions and central banks	(9,818)	(10,956)
Financial liabilities at amortised cost – promissory notes issued to credit institutions	(196,782)	(137,133)
<b>Cash and cash equivalents</b>	<b>88,015</b>	<b>43,404</b>

#### Change in operating assets

(CZKm)	2016	2015
Net change in financial assets held for trading	8,935	22,025
Net change in financial assets designated at fair value through profit or loss	6	3,186
Net change in available-for-sale financial assets	(3,518)	(4,455)
Net change in loans and receivables	(31,658)	(26,182)
Net change in derivatives used for hedging	(548)	1,376
Net change in other assets	105	(173)
	<b>(26,678)</b>	<b>(4,223)</b>

#### Change in operating liabilities

(CZKm)	2016	2015
Net change in financial liabilities held for trading	9,983	(39,736)
Net change in financial liabilities designated at fair value through profit or loss	1,620	-
Net change in financial liabilities at amortised cost	53,522	25,928
Net change in derivatives used for hedging	(250)	(1,150)
Net change in other liabilities	330	469
	<b>65,205</b>	<b>(14,489)</b>

#### Non-cash items included in profit before tax

(CZKm)	2016	2015
Amortisation of discounts and premiums in investment securities	1,512	1,199
Depreciation and amortisation	947	325
Net change in fair value adjustments of the hedged items in portfolio hedge	803	(410)
Allowances and provisions for credit losses (Note: 11)	498	540
Impairment of intangible assets (Note: 11)	74	-
Creation of provisions	47	(188)
Impairment on property and equipment (Note: 11)	9	-
Impairment on other assets (Note: 11)	1	-
Impairment on investment securities (Note: 11)	-	10
Impairment of non-current assets held-for-sale (Note: 11)	-	9
Foreign exchange differences in held-to-maturity investments	(129)	530
Other	197	390
	<b>3,959</b>	<b>2,405</b>



## 32. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

The following table sets out the financial assets and liabilities of the Bank by expected remaining maturity as at 31 December 2016:

(CZKm)	Less than 1 year	1 year to 5 years	More than 5 years	Without maturity	Total
<b>ASSETS</b>					
Cash and balances with Central banks (Note: 14)	46,846	-	-	-	46,846
Financial assets held for trading					
Financial derivatives	3,836	6,731	2,451	-	13,018
Other than financial derivatives	1,064	3,200	4,434	-	8,698
Financial assets designated at fair value through profit or loss	28	-	3,457	-	3,485
Available-for-sale financial assets	21,891	12,967	37,867	342	73,067
Loans and receivables	353,051	200,430	145,259	-	698,740
Fair value adjustments of the hedged items in portfolio hedge	563	234	-	-	797
Held-to-maturity investments	18,643	64,652	49,384	-	132,679
Derivatives used for hedging	2,727	6,922	1,974	-	11,623
Other assets (Note: 23)	792	-	-	-	792
<b>Total carrying value</b>	<b>449,441</b>	<b>295,136</b>	<b>244,826</b>	<b>342</b>	<b>989,745</b>
<b>LIABILITIES</b>					
Financial liabilities held for trading					
Financial derivatives	3,616	6,651	2,179	-	12,446
Other than financial derivatives	18,588	6,720	2,314	-	27,622
Financial liabilities designated at fair value through profit or loss	57	1,248	315	-	1,620
Financial liabilities at amortised cost	311,866	282,237	315,531	-	909,634
Fair value adjustments of the hedged items in portfolio hedge	545	2,938	1,313	-	4,796
Derivatives used for hedging	2,728	5,541	2,149	-	10,418
Other liabilities (Note: 26)	3,814	-	-	-	3,814
<b>Total carrying value</b>	<b>341,214</b>	<b>305,335</b>	<b>323,801</b>	<b>-</b>	<b>970,350</b>

The following table sets out the financial assets and liabilities of the Bank by expected remaining maturity as at 31 December 2015:

(CZKm)	Less than 1 year	1 year to 5 years	More than 5 years	Without maturity	Total
<b>ASSETS</b>					
Cash and balances with Central banks (Note: 14)	107,076	-	-	-	107,076
Financial assets held for trading					
Financial derivatives	3,863	5,917	1,741	-	11,521
Other than financial derivatives	6,034	9,058	4,038	-	19,130
Financial assets designated at fair value through profit or loss	32	-	3,459	-	3,491
Available-for-sale financial assets	11,810	29,110	32,165	1,304	74,389
Loans and receivables	192,898	181,506	127,264	-	501,668
Fair value adjustments of the hedged items in portfolio hedge	420	446	-	-	866
Held-to-maturity investments	10,542	72,041	53,849	-	136,432
Derivatives used for hedging	2,584	6,996	2,326	-	11,906
Other assets (Note: 23)	898	-	-	-	898
<b>Total carrying value</b>	<b>336,157</b>	<b>305,074</b>	<b>224,842</b>	<b>1,304</b>	<b>867,377</b>
<b>LIABILITIES</b>					
Financial liabilities held for trading					
Financial derivatives	4,175	6,030	2,092	-	12,297
Other than financial derivatives	11,752	3,688	2,348	-	17,788
Financial liabilities at amortised cost	249,277	254,265	293,559	-	797,101
Fair value adjustments of the hedged items in portfolio hedge	609	2,137	1,316	-	4,062
Derivatives used for hedging	2,649	5,653	2,366	-	10,668
Other liabilities (Note: 26)	4,421	-	-	-	4,421
<b>Total carrying value</b>	<b>272,883</b>	<b>271,773</b>	<b>301,681</b>	<b>-</b>	<b>846,337</b>

### 33. CONTINGENT ASSETS, LIABILITIES AND COMMITMENTS

#### Contingent assets

Based on a court ruling, the Bank recovered a written-off loan amounting to CZK 485 m in 2007. Due to the uncertainty regarding the continuing court proceedings, following the appeal by the counterparty against the decision, the Bank will not recognise this amount in the statement of income until the final court decision regarding the Bank's claim. In 2011, the original court ruling was cancelled and the legal case was passed to the court in the first instance for new judicial proceedings. Based on that decision, the Bank returned the expenses compensation of CZK 3 m from the total received amount from the original court case to the counterparty. Judicial proceeding is continuing at the Supreme court.

### Contingent liabilities and commitments

The contingent liabilities and commitments at 31 December 2016 and 2015 are as follows:

(CZKm)	2016	2015
Loan commitments - irrevocable (Note: 38.2)	95,191	91,309
Loan commitments - revocable	48,225	42,879
Financial guarantees (Note: 38.2)	32,243	28,291
Other commitments (Note: 38.2)	1,324	1,381
	<b>176,983</b>	<b>163,860</b>
Provisions for loan commitments and guarantees (Notes: 27, 38.2)	232	285

Revocable loan commitments are such commitments in which the Bank may at any time limit the amount that may be drawn under the credit limit. Further the Bank may not provide any drawdown under the credit facility requested by the client or the Bank can suspend further drawdowns under the credit facility all together. The Bank can do so with or without specifying the reason, giving a prior notice or stipulating any time limit. Loan commitments which do not meet the above definition are assessed as irrevocable.

The contractual amounts described above represent the maximum credit risk that would arise if the contracts were fully drawn, the customers defaulted and the value of any existing collateral became worthless. Many of the commitments are collateralised and most are expected to expire without being drawn upon; therefore, the total commitment contractual amounts do not necessarily represent the risk of loss or future cash requirements (Note: 38.3).

### Litigation

Other than the litigations, for which provisions have already been made (Note: 27), the Bank is named in and is defending a number of legal actions in various jurisdictions arising in the ordinary course of business. The Bank does not believe that the ultimate resolution of these legal actions will result in a material impact on the financial position of the Bank.

The Bank is subject to a number of claims in the context of the IPB acquisition amounting to tens of billions of Czech Crowns. The Bank believes that such claims are unfounded. In addition, the Bank believes that potential risk arising from such claims is covered by guarantee agreements issued by the institutions of the Czech state.

Further, the Bank has initiated a number of legal actions to protect its assets.

### Taxation

Czech tax legislation, interpretation and guidance are still evolving. Consequently, under the current taxation environment, it is difficult to predict the interpretations that the respective tax authorities may apply in a number of areas. As a result, the Bank has used its current understanding of the tax legislation in the design of its planning and accounting policies. The effect of the uncertainty cannot be quantified.

### Operating lease commitments (Bank is the lessee)

Future minimum lease payments under operating leases related to information technologies, land and buildings are as follows:

(CZKm)	2016	2015
Not later than 1 year	670	779
Later than 1 year and not later than 5 years	1,626	1,054
Later than 5 years	195	176
	<b>2,491</b>	<b>2,009</b>

Future minimum sublease payments amounted to CZK 56 m as at 31 December 2016 (31 December 2015: CZK 56 m).

The operating leases related to land and buildings can be technically cancelled under the Czech law; however, the Bank is commercially bound to continue with these leases for the periods set out above.

**Operating lease receivables (Bank is the lessor)**

Future minimum lease payments (including sublease payments) under operating leases related to land and buildings are as follows:

(CZKm)	2016	2015
Not later than 1 year	26	26
Later than 1 year and not later than 5 years	14	30
	<b>40</b>	<b>56</b>

These operating leases can be technically cancelled under Czech law; however, the lessees are commercially bound to continue with these leases for the periods set out above.

**Other contingent liabilities – construction of new headquarter building**

In 2016, the Bank committed to its subsidiary Radlice Rozvojová and to the developer to finance the development of a new headquarter building in the amount of CZK 1,832 m.

**34. REPURCHASE AGREEMENTS AND COLLATERAL**

The following table shows an analysis of the loans the Bank has made to counterparties in reverse repurchase agreements according to the lines of the statement of financial position in which they are included:

(CZKm)	2016	2015
<b>Financial assets</b>		
Loans and receivables	235,046	70,094
	<b>235,046</b>	<b>70,094</b>

Under reverse repurchase agreements, the Bank obtains legal ownership of the respective collateral received and, thus, is permitted to use the collateral; however, the same collateral must be delivered back to the borrower of the funds on maturity.

The fair value of financial assets accepted as collateral in connection with reverse repo transactions and securities lending as at 31 December 2016 was CZK 236,345 m, of which CZK 16,596 m has been either sold or repledged (31 December 2015: CZK 71,668 m and CZK 10,046 m, respectively).

The following table shows an analysis of the loans the Bank has received from counterparties in repurchase agreements according to the lines of the statement of financial position in which they are included:

(CZKm)	2016	2015
<b>Financial liabilities</b>		
Financial liabilities at amortised cost	9,452	-
	<b>9,452</b>	<b>-</b>

The Bank contracts repo operations under the standard conditions currently applied on the market. Amounts of financial assets pledged as collateral in repo transactions and securities lending are described in Financial assets at fair value through profit or loss (Note: 15) and Financial investments (Note: 16).

### 35. OFFSET FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The following table shows an analysis of the financial assets and liabilities of the Bank that have been set-off or that are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2016:

(CZKm)	Gross amounts of recognised financial instrument	Gross amounts of recognised financial instrument set off	Net amounts of financial instrument presented in the balance sheet
<b>FINANCIAL ASSETS</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	19,087	-	19,087
Derivatives not set-off that are not subject to an enforceable master netting arrangement	5,554	-	5,554
<b>Total trading and hedging derivatives</b>	<b>24,641</b>	<b>-</b>	<b>24,641</b>
Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement	235,046	-	235,046
<b>Total repurchase agreements (Note: 34)</b>	<b>235,046</b>	<b>-</b>	<b>235,046</b>
Other financial assets not set-off that are not subject to an enforceable master netting arrangement	792	-	792
<b>Total other financial assets (Note: 23)</b>	<b>792</b>	<b>-</b>	<b>792</b>
<b>FINANCIAL LIABILITIES</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,647	-	20,647
Derivatives not set-off that are not subject to an enforceable master netting arrangement	2,217	-	2,217
<b>Total trading and hedging derivatives</b>	<b>22,864</b>	<b>-</b>	<b>22,864</b>
Repurchase agreements not set-off that are subject to an enforceable master netting arrangement	9,452	-	9,452
<b>Total repurchase agreements (Note: 34)</b>	<b>9,452</b>	<b>-</b>	<b>9,452</b>
Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement	3,814	-	3,814
<b>Total other financial liabilities (Note: 26)</b>	<b>3,814</b>	<b>-</b>	<b>3,814</b>

The following table shows an analysis of the financial assets and liabilities of the Bank that have been set-off or that are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2015:

(CZKm)	Gross amounts of recognised financial instrument	Gross amounts of recognised financial instrument set off	Net amounts of financial instrument presented in the balance sheet
<b>FINANCIAL ASSETS</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	18,591	-	18,591
Derivatives not set-off that are not subject to an enforceable master netting arrangement	4,836	-	4,836
<b>Total trading and hedging derivatives</b>	<b>23,427</b>	<b>-</b>	<b>23,427</b>
Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement	70,094	-	70,094
<b>Total repurchase agreements (Note: 34)</b>	<b>70,094</b>	<b>-</b>	<b>70,094</b>
Other financial assets set-off in the balance sheet	221	221	-
Other financial assets not set-off that are not subject to an enforceable master netting arrangement	898	-	898
<b>Total other financial assets (Note: 23)</b>	<b>1,119</b>	<b>221</b>	<b>898</b>
<b>FINANCIAL LIABILITIES</b>			
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,676	-	20,676
Derivatives not set-off that are not subject to an enforceable master netting arrangement	2,289	-	2,289
<b>Total trading and hedging derivatives</b>	<b>22,965</b>	<b>-</b>	<b>22,965</b>
Other financial liabilities set-off in the balance sheet	221	221	-
Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement	4,421	-	4,421
<b>Total other financial liabilities (Note: 26)</b>	<b>4,642</b>	<b>221</b>	<b>4,421</b>

The following table shows an analysis of the financial assets and liabilities of the Bank that have not been set-off and are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2016:

(CZKm)	Net amounts of financial assets presented in the balance sheet	Amounts not set off in the balance sheet			Total net amount
		Financial instruments	Cash collateral	Securities collateral	
<b>FINANCIAL ASSETS</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	19,087	17,747	1,054	-	286
Debt securities pledged as collateral in repo transaction not set-off that are subject to an enforceable master netting arrangements	9,452	9,452	-	-	-
<b>Total carrying value</b>	<b>28,539</b>	<b>27,199</b>	<b>1,054</b>	<b>-</b>	<b>286</b>
<b>FINANCIAL LIABILITIES</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,647	17,747	2,699	-	201
Repurchase agreements not set-off that are subject to an enforceable master netting arrangement	9,452	-	-	9,452	-
<b>Total carrying value</b>	<b>30,099</b>	<b>17,747</b>	<b>2,699</b>	<b>9,452</b>	<b>201</b>

The following table shows an analysis of the financial assets and liabilities of the Bank that have not been set-off and are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2015:

(CZKm)	Net amounts of financial assets presented in the balance sheet	Amounts not set off in the balance sheet			Total net amount
		Financial instruments	Cash collateral	Securities collateral	
<b>FINANCIAL ASSETS</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	18,591	17,217	993	-	381
<b>Total carrying value</b>	<b>18,591</b>	<b>17,217</b>	<b>993</b>	<b>-</b>	<b>381</b>
<b>FINANCIAL LIABILITIES</b>					
Derivatives not set-off that are subject to an enforceable master netting arrangement	20,676	17,217	3,234	-	225
<b>Total carrying value</b>	<b>20,676</b>	<b>17,217</b>	<b>3,234</b>	<b>-</b>	<b>225</b>

The amounts in both tables are subject to master netting agreement in accordance with International Swaps and Derivatives Association (ISDA), however with no intention to settle them on a net basis.



**36. RELATED PARTY DISCLOSURES**

A number of transactions are executed with related parties in the normal course of business.

The outstanding balances of assets from related party transactions as at 31 December 2016 are as follows:

(CZK m)	Financial assets held for trading	Financial assets designated at fair value through profit or loss	Available- for-sale financial assets	Loans and receivables	Derivatives used for hedging	Other assets
Directors / Top management	-	-	-	-	-	-
KBC Bank NV	2,928	-	-	1,311	7,867	-
Entities under common control						
ČSOB SK	1	-	-	36	-	15
KBC Investments Limited	211	-	-	-	-	-
Other	33	-	-	136	-	-
Subsidiaries						
BANIT	-	-	-	126	-	-
Centrum Radlická	-	-	-	1,648	-	-
ČSOB Factoring	-	-	-	2,336	-	-
ČSOB Leasing	69	-	-	24,068	-	-
Hypoteční banka	1,822	3,512	16,244	183,084	6	-
Patria Finance (member of Patria group)	-	-	-	159	-	-
Associates						
ČSOB AM	-	-	-	130	-	-
ČSOB Pojišťovna	396	-	-	-	-	8
Joint ventures						
ČMSS	-	-	-	40	-	-

The outstanding balances of liabilities from related party transactions as at 31 December 2016 are as follows:

(CZK m)	Financial liabilities held for trading	Financial liabilities at amortised cost	Derivatives used for hedging	Other liabilities
Directors / Top management	-	96	-	57
KBC Bank NV	3,328	200,705	8,507	-
Entities under common control				
ČSOB SK	4	42	-	-
KBC Investmenten Limited	35	182	-	-
Other	12	153	-	-
Subsidiaries				
BANIT	-	-	-	20
Centrum Radlická	-	3	-	-
ČSOB Advisory	-	432	-	-
ČSOB Leasing	2	72	-	-
ČSOB Property fund	-	115	-	-
Hypoteční banka	47	6,622	21	-
Patria Corporate Finance (member of Patria group)	-	3	-	-
Patria Finance (member of Patria group)	-	318	-	-
Patria Online	-	20	-	-
Radlice Rozvojová	-	10	-	-
Associates				
ČSOB AM	-	594	-	-
ČSOB Pojišťovna	21	1,368	-	-
Joint ventures				
ČMSS	-	6,043	-	-

The outstanding balances of assets from related party transactions as at 31 December 2015 are as follows:

(CZK m)	Financial assets held for trading	Financial assets designated at fair value through profit or loss	Available-for-sale financial assets	Loans and receivables	Derivatives used for hedging	Other assets
Directors / Top management	-	-	-	-	-	-
KBC Bank NV	2,685	-	-	1,277	7,439	1
Entities under common control						
ČSOB SK	157	-	-	27	1	-
KBC Internationale Financieringsmij NV	149	-	-	-	-	-
Other	159	-	-	145	-	-
Subsidiaries						
BANIT	-	-	-	102	-	2
Centrum Radlická	-	-	-	1,732	-	-
ČSOB Factoring	-	-	-	2,961	-	-
ČSOB Leasing	63	-	-	25,287	-	-
Hypoteční banka	1,250	3,514	15,479	158,367	6	-
Patria Finance (member of Patria group)	-	-	-	152	-	-
Radlice Rozvojová	-	-	-	-	-	3
Associates						
ČSOB AM	-	-	-	9	-	-
ČSOB Pojišťovna	413	-	-	-	-	9
Joint ventures						
ČMSS	-	-	-	40	-	-

The outstanding balances of liabilities from related party transactions as at 31 December 2015 are as follows:

(CZKm)	Financial liabilities held for trading	Financial liabilities at amortised cost	Derivatives used for hedging	Other liabilities
Directors / Top management	-	60	-	59
KBC Bank NV	2,699	138,596	8,468	-
Entities under common control				
ČSOB SK	3	36	-	-
KBC Group	-	1	-	966
Other	26	192	-	-
Subsidiaries				
BANIT	-	-	-	18
Centrum Radlická	-	11	-	-
ČSOB Advisory	-	15	-	-
ČSOB Leasing	6	54	-	-
ČSOB Penzijní společnost	-	250	-	-
ČSOB Property fund	-	172	-	-
Hypoteční banka	21	6,622	-	-
Patria Corporate Finance (member of Patria group)	-	6	-	-
Patria Finance (member of Patria group)	-	305	-	-
Patria Online	-	148	-	-
Radlice Rozvojová	-	23	-	-
Associates				
ČSOB AM	-	109	-	-
ČSOB Pojišťovna	9	1,725	-	-
Joint ventures				
ČMSS	-	6,712	-	-

The outstanding balances of assets and liabilities with KBC Bank NV and the entities under common control principally comprise the fair value of derivative financial instruments, debt instruments and repo transactions.

The Bank provides banking services to its subsidiaries, associates and joint ventures such as provided loans, overdrafts, interest bearing deposits and current accounts as well as other services. In addition, the Bank acquired interest bearing debt instruments issued by its subsidiaries.

The outstanding balances, described above, arose in the ordinary course of business and are subject to the substantially same terms, including interest rates and security, as for comparable transactions with third party counterparties.

The balances of interest income and expense from related party transactions for the year ended 31 December are as follows:

(CZKm)	2016		2015	
	Interest income	Interest expense	Interest income	Interest expense
Directors / Top management	-	-	-	-
KBC Bank NV	1,106	683	1,290	1,068
Entities under common control				
ČSOB SK	3	1	9	-
KBC Internationale Financieringsmij NV	-	-	8	-
Subsidiaries				
BANIT	2	-	2	-
Centrum Radlická	53	-	55	-
ČSOB Factoring	13	-	17	-
ČSOB Advisory	-	1	-	1
ČSOB Leasing	266	-	286	-
Hypoteční banka	2,229	408	2,678	530
Patria Finance (member of Patria group)	2	-	1	-
Associates				
ČSOB Pojišťovna	-	20	-	21
Joint ventures				
ČMSS	1	85	53	178

The balances of fee and commission income and expenses from related party transactions for the year ended 31 December are as follows:

(CZKm)	2016		2015	
	Fee and commission income	Fee and commission expense	Fee and commission income	Fee and commission expense
KBC Bank NV	83	1	62	10
Entities under common control				
ČSOB SK	-	5	-	30
KBC Group	-	-	-	35
KBC Securities NV	10	-	11	-
Other	-	-	-	4
Subsidiaries				
BANIT	-	190	-	160
ČSOB Factoring	1	-	2	-
ČSOB Leasing	13	2	9	1
ČSOB Penzijní společnost	10	-	10	-
Hypoteční banka	246	127	217	75
Patria Finance (member of Patria group)	8	-	4	-
Associates				
ČSOB AM	466	-	455	-
ČSOB Pojišťovna	170	-	171	6
Joint ventures				
ČMSS	14	2	6	3

Dividend income received from subsidiaries, associates and joint ventures in 2016 amounted to CZK 4,856 m (2015: CZK 5,302 m). Rental expenses paid to subsidiaries, associates and joint ventures in 2016 amounted to CZK 189 m (2015: CZK 187 m).

In accordance with the Group strategy, information and communication services were reintegrated from the KBC Group Czech Branch back to ČSOB in 2015. Based on the acquisition agreement, concluded between the ČSOB and the KBC Group, selected activities and processes of the KBC Group Czech Branch, including employees (Note: 9), assets and liabilities related to the ICT function, were acquired by the Bank on 31 December 2015 (Note: 18).

Effective from 1 July 2009, the Bank concluded an office space rental agreement and a service level agreement on the provision of administration services, such as human resources and accounting services, with KBC Group. In 2016, the Bank received income of CZK Nil (2015: CZK 72 m) from the rental payments and related services, received CZK 68 m (2015: CZK 59 m) from the provision of administration services and paid expense of CZK 591 m (2015: CZK 3,192 m) for IT services, including rental expenses on information technologies.

In 2016, the Bank received income of CZK 569 m (2015: CZK 87 m) from ČSOB SK and ČSOB Pojišťovna arising from providing services and support in the following areas such as: ICT services, electronic banking, cards, payment processing, financial management and risk management.

The outstanding contractual balances of the contingent assets and liabilities to the related parties at 31 December are as follows:

(CZKm)	2016		2015	
	Guarantees received	Guarantees given	Guarantees received	Guarantees given
KBC Bank NV	2,222	194	2,596	191
Entities under common control				
ČSOB SK	2,343	23	1,815	145
Kereskedelmi és Hitelbank Rt.	232	23	270	23
Merrion Properties	-	323		
Subsidiaries				
ČSOB Leasing	-	1,677	-	-
Associates				
ČSOB Pojišťovna	-	-	-	1

The outstanding balances of guarantees received from KBC Bank NV and the entities under common control principally comprise sub-participation arrangements and other compensation commitments.

In 2016, the Bank committed to its subsidiary Radlice Rozvojová and to the developer to finance the development of a new headquarter building in the amount of CZK 1,832 m.

## 37. EVENTS AFTER THE END OF THE REPORTING PERIOD

There were no events after the reporting period.

## 38. RISK MANAGEMENT

### 38.1 Introduction

Risk is an inherent part of ČSOB's activities, and risk and capital management is critical to the results of operations and financial condition of ČSOB.

The principal risks that ČSOB faces are credit risk, liquidity risk, operational and other non-financial risks, market risk, subdivided into trading (trading portfolio) and non-trading (credit and investment portfolio) risks. ČSOB manages risk and capital through a system of ongoing identification, measurement and monitoring, subject to risk and capital limits and other controls. ČSOB primarily allocates capital to each subsidiary and business unit with the aim of achieving an acceptable balance between risk and return. The Bank's risk and capital management system is based on a risk strategy determined by the ČSOB Board of Directors and is consistent with the KBC Group's risk and business strategy, with a primary focus on the early identification and management of risks and trends. ČSOB maintains and develops its risk and capital management system to meet its ongoing internal risk and capital management needs and to comply with all legal and other regulatory (capital) requirements, including Basel III, and the regulations of the CNB, European Central Bank (ECB), European Banking Authority (EBA) and other relevant bodies.



## Risk and Capital Management Organization

### *Main Principles of Risk and Capital Management Organization*

The Bank's risk and capital management organization is based on the principle of segregating risk origination and acceptance from risk monitoring and control. The risk and capital management and control functions are designed to be exercised independently of the front office functions.

Nevertheless, the front office is engaged in risk and capital management and control functions and is responsible in the first instance for risk control in all risk and capital management areas. The aim of risk and capital management at ČSOB is to closely cooperate with the business in achieving an acceptable balance between return and risk, as opposed to focusing solely on minimising risks.

The risk and capital management governance model that was implemented within the ČSOB in 2011 is based on the following general principles:

- the business, including both sales and credit departments, should be responsible in the first instance for risk and capital management, and must systematically take into account risk and capital management considerations into all its decisions;
- risk and capital management, and risk reporting, should be performed consistently within the entire KBC Group, including ČSOB, and management incentives should be linked to risk and capital adjusted measures, and aligned consistently within the entire KBC Group;
- the risk and capital management governance structure should be an independent and vertically integrated structure aimed at ensuring that risk and capital management considerations are properly reflected in the business decisions within ČSOB;
- risk and capital management should closely cooperate with the business with the aim of achieving an acceptable balance between return and risk, as opposed to focusing only on minimising risks;
- the Board of Directors should determine the risk appetite of ČSOB within which the business has the right to take risks and beyond which the Chief risk officer (CRO) can intervene; and
- the risk reporting processes should be uniform and insightful to allow for the adoption of risk and capital management decisions at both strategic and implementation levels.

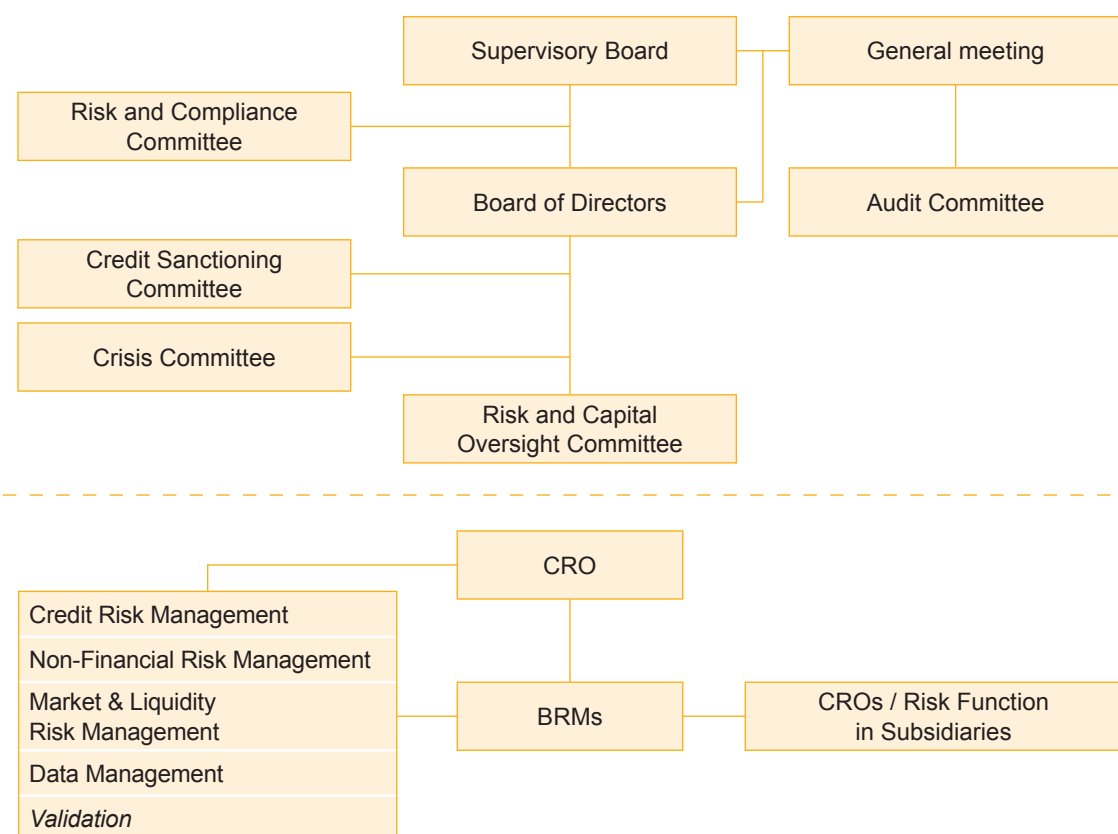
The principles described above establish a governance structure, within which:

- (i) the Board of Directors is responsible for determining the risk appetite of ČSOB, and capital allocation within ČSOB, by establishing measurable risk and capital parameters, which must be followed in all business activities;
- (ii) the Risk and Capital Oversight Committee (RCOC) is responsible for proposing the risk appetite and capital allocation to the Board of Directors, translating the approved risk appetite and capital allocation into numerical risk limits within its delegated authority, and regular monitoring of risk and capital against these limits;
- (iii) the CRO, together with the Risk Function, as described below, is responsible for designing the frameworks in which risk management should take place, for translating the risk limits into policies and for ensuring that monitoring systems are in place; and
- (iv) the business is responsible for taking risks within the risk and capital allocation.

### Risk and Capital Management Governance

Risk and capital governance in the Bank is fully embedded in the governance of the KBC Group. During 2015, a few changes were put in place to take account of changes in the organisational structure of ČSOB. Most importantly, the Risk and Compliance Committee was established as a sub-committee of the Supervisory Board with a specific focus on risk management and compliance matters.

The chart below depicts an overview of the principal bodies of the risk and capital governance model in the Bank.



The Bank operates a three-line of defense risk management model whereby front office functions, risk management oversight and assurance roles are played by functions independent of one another. The model is characterised primarily by:

- the Board of Directors, assisted by the Audit Committee, Supervisory Board and its Committees,
- the Risk and Capital Oversight Committee,
- an independent Chief Risk Officer, supported by the independent Risk Function, and
- risk-aware business people, who act as the first line of defence ensuring that a risk control environment is established as part of day-to-day operations.

#### Supervisory Board

In its main role, the Supervisory Board oversees whether the governance of the Bank is efficient, comprehensive and adequate, and regularly evaluates the findings obtained from this activity. Its oversight role consists in providing constructive challenge when developing the strategy of the Bank; monitoring of the performance of the management function and the realisation of agreed goals and objectives, business and risk strategies; and ensuring the integrity of the financial information, effective risk management and internal controls (including proper segregation of duties within the Bank).

The Supervisory Board regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

The Supervisory Board:

- (i) Oversees whether the system of risk governance is efficient, comprehensive and adequate;
- (ii) Regularly discuss matters concerning the risks to which the Bank is or might be exposed;
- (iii) Continuously oversees and assures itself of the fulfilment of the risk management strategy and of the operational control's reliability;
- (iv) Critically and constructively participates in the evaluation of the management of risks;
- (v) Comments on a proposal (of the KBC Group CRO) to entrust as well as dismiss a natural person with the ensuring of the performance of the risk management function, stipulates policies governing remuneration of that person and assesses the activities of the person.

#### *Risk and Compliance Committee*

The Supervisory Board established the Risk and Compliance Committee which is mainly responsible for advising the Supervisory Board on the Bank's overall current and future risk profile, appetite and strategy, and for overseeing the implementation of that strategy.

The Committee regularly discusses risk management and compliance related matters and communicates with the Bank's risk control function and Chief Risk Officer. In addition, the Risk and Compliance Committee assists the Supervisory Board in the establishment of sound remuneration policies and practices, examines whether incentives provided by the remuneration system take into consideration risk, capital, liquidity likelihood and timing of earnings.

The Committee reviews the activities, structure, independence, professionalism and expertise of Risk management.

The Committee regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

#### *Audit Committee*

The Audit Committee, inter alia, monitors the effectiveness of the Bank's internal control, internal audit, risk management systems, establishment of accounting policies by the institution and procedures in preparing the financial statements of the Bank.

With regards to external audit, the Committee oversees the Bank's external auditors, monitors the process of mandatory audits of the financial statements and consolidated financial statements, assesses the independence of statutory auditors and the auditing firm(s), recommends for approval by the management body the appointment, compensation and appointment of the external auditors; review and approves the audit scope and frequency; review audit reports.

In addition to that the Committee checks that the management body in its management function takes necessary corrective actions in a timely manner to address control weaknesses, non-compliance with laws, regulations and policies, and other problems identified by the auditors.

#### *Board of Directors (BoD)*

The Board of Directors has the overall responsibility for the Bank, proposes its strategic direction within applicable legal and regulatory framework taking into account the institution's long-term financial interests and solvency; ensures the effective implementation of the strategy and is responsible for the day-to-day running of the Bank.

The Board of Directors generally ensures that comprehensive and adequate internal control and risk governance system is established good functioning and efficient, in its entirety and in parts. With regards to the risk management function, the Board of Directors:

- (i) Ensures earmarking of adequate and sufficient capacities for management of significant risks, capital and liquidity management, internal models and validations/reviews of such models;
- (ii) Approves and regularly evaluates the implementation of:
  - Risk Management Charter,
  - Risk Appetite of ČSOB,
  - Result of Risk Scan,
  - Risk Management Strategy,
  - Risk Management Framework (including risk specific frameworks),
  - Limit Book and Framework,
  - Internal Capital Adequacy Assessment Process and Capital Adequacy Policy,
  - Recovery and Resolution plan,
  - Information Security Strategy;
- (iii) Evaluates the overall functioning and efficiency of the internal control and governance system (Internal Control Assessment to ČSOB Supervisory Board), and ensures appropriate steps to rectify the potential identified shortcomings.

On the basis of monthly integrated risk management reports prepared by the Risk Function, the Board of Directors is also responsible for monitoring whether ČSOB's risk profile is in line with ČSOB's risk appetite, limits system and making decisions on risk and capital management issues that may be escalated to its attention by the CRO or the RCOC, as described below.

#### *Risk and Capital Oversight Committee (RCOC)*

The RCOC assists the Board of Directors in monitoring ČSOB's risk and capital management exposures against the limits set by the Board of Directors. The key responsibilities of the RCOC regarding risk and capital management matters are to:

- (i) propose to the Board of Directors the Bank's Risk Appetite;
- (ii) propose to the Board of Directors a framework of limits consistent with the Bank's Risk Appetite, within which Risk and Capital will be managed;
- (iii) provide an integrated view on Risk exposure against Risk Appetite/Limits and identify/report on 'hidden risks' (including concentration); In the event of Risk exposure being in excess of limit(s), to recommend to the BoD material mitigating actions and decide on non-material mitigating actions to bring Risk exposure back in line;
- (iv) periodically review limits and, as necessary, to recommend to the BoD material changes in limit (s) and to decide on non – material limit changes;
- (v) monitor market context, solvency, liquidity, risk/return profile, balance sheet profile, maturity transformation and structural interest rate exposure;
- (vi) monitor capital adequacy and usage of Regulatory and Economic Capital.

The RCOC reviews regular risk reports prepared by the Risk Function, which are then submitted to the Board of Directors, the Audit Committee and the Supervisory Board. These reports form the basis for the risk monitoring process. Further ad hoc reports may be prepared and submitted, where relevant. The CRO is the chairman and the CFO is the vice-chairman of the Committee.

### *Chief Risk Officer (CRO)*

The Chief Risk Officer (CRO), who is a member of the Board of Directors, is in general responsible for the identification, assessment and reporting of risks arising within operations across all business and all risk types, and has a direct management responsibility for the following risk management functions / departments:

- (i) Credit Risk Management;
- (ii) Market and Liquidity Risk Management;
- (iii) Non-financial Risk Management;
- (iv) Validations; and
- (v) Data Management.

The CRO:

- (i) Ensures that risk management processes are effective and efficient, promotes a culture of risk aware business conduct and prudent risk management;
- (ii) Ensures compliance with Group (KBC) and regulatory requirements in the field of risk management;
- (iii) Recommends the need for action to address risk & capital issues raised in internal reports;
- (iv) Inputs to corrective actions to address local underperformance versus targets and agree to final actions to ensure within risk playing field;
- (v) Assess the rate and structure of risk undertaken and the impact thereof on the performance and stability;
- (vi) Coordinates the field of continuity management for the business;
- (vii) Provides risk and capital reporting to internal (senior management, Board of Directors, Risk and Compliance Committee, Subsidiaries) and external clients (KBC, CNB);
- (viii) Presents information concerning the developments in the field of risk management to ČSOB and KBC management;
- (ix) Advices on risk related matters to Management Board of subsidiaries within the Group that have a separate legal structure.

The key strategic and governance responsibilities of the CRO are to:

- (i) Recommend Risk Governance structure and roles;
- (ii) Decide the structure of the Risk Function;
- (iii) Input to the Risk Appetite;
- (iv) Input to the corporate Strategy / strategic plans (including performance targets) development and agree to final Strategy to ensure within risk playing field;
- (v) Recommend Risk and Capital Management Strategy;
- (vi) Input to limits and delegation of authority setting within and below BoD delegation and agree to final decision to ensure within risk playing field;
- (vii) Input to capital and funding allocation and agree to final allocation to ensure within risk playing field.

The CRO, in its role has following key execution activities:

- (i) Recommend and decide on changes to the Risk Function owned frameworks;
- (ii) Decide on validation of transactional models for risk management;
- (iii) Input to guidelines for portfolio and transactional model development;
- (iv) Input or decide (in line with the delegation rules) on mitigating actions for limit overruns and agree to final decision to ensure within risk playing field;
- (v) Recommend and/or decide ex-post actions to address compliance issues with risk frameworks;
- (vi) Ensure the process of assessment and evaluation of the regulatory / internally determined capital adequacy and conduct stress testing;
- (vii) Input to day to day business decisions as a trusted advisor;
- (viii) Agree to risk taking decisions outside of the risk playing field with the right to call "time out".

The CRO may suspend any decisions of any department or committee, or any business unit or sub-unit, affecting the risk or capital position of ČSOB by escalating it to the RCOC or the Board of Directors.

#### *Risk Function*

The Risk Function provides independent oversight of the management of risks inherent in the Bank's activities. The function is generally responsible for ensuring that effective processes are in place for:

- (i) Identifying current and emerging risks;
- (ii) Developing risk assessment and measurement systems;
- (iii) Establishing policies, practices and other control mechanisms to manage risks;
- (iv) Developing risk tolerance limits for Senior Management and Board approval;
- (v) Monitoring positions against approved risk tolerance limits; and
- (vi) Reporting results of risk monitoring to Senior Management and the Board.

The Risk Function is represented by the following departments reporting to the CRO - Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management, Data Management and Validations. The departments have the following roles:

#### *Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management*

Particular risk management departments are responsible for managing credit risk, market risk, liquidity risk and operational risk. In particular, they are responsible for:

- (i) ensuring that the risk frameworks specific to these types of risks are in place and properly implemented and;
- (ii) monitoring the risk limits and proposing changes to these risk limits or corrective actions to be taken in response to breaches of these risk limits;
- (iii) information security frameworks for informational risk, including cyber risk, and the monitoring of these risks;
- (iv) integrated risk reporting (see Risk Monitoring and Reporting below);
- (v) the management of economic capital.

Within the Non-financial Risk Management department, the information security officer is responsible for determining the risk frameworks for informational risk, including cyber risk, and the monitoring of these risks.

### *Data Management*

Data Management is responsible for supporting all the other departments forming the Risk Function in data management and reporting. In particular:

- (i) maintaining all ICT applications needed for the performance of risk and capital management;
- (ii) designing the technical ICT architecture in cooperation with the ICT; and
- (iii) performing activities aimed at ensuring the correct flow of data needed for proper risk and capital monitoring.

Data Management is responsible for risk data governance and also forms the link between the requirements of the Risk Function and ICT.

### *Central Credit risk and loss Measurement Validation*

Central Credit risk and loss Measurement Validation focuses on reducing of model risk and seeks a group-wide consistency by providing a well-founded, intelligible and timely independent second opinion and methodological guidance on models for risk measurement and provisioning to their owners, decision bodies and modellers.

### *Risk Integration*

Furthermore, specific team within the Risk Function covers overarching aspects of risk management. It's mandate is to provide an increased focus on holistic risk management and cross-risk oversight to further enhance our risk management. Key objectives are to:

- (i) drive key strategic cross-risk initiatives and establish greater cohesion between defining portfolio strategy and governing execution, including regulatory adherence and recovery planning;
- (ii) provide a strategic and forward-looking perspective on the key risk issues for discussion at senior levels within the Bank (risk appetite, stress testing framework);
- (iii) strengthen risk culture at the Bank; and
- (iv) foster the implementation of consistent risk management standards.

Risk Integration is responsible for managing the process of measuring and monitoring risk on an integrated basis within the Bank. In particular, Risk Integration performs the ICAAP process (see ICAAP Process below), including the management of economic capital, and was responsible for integrated risk reporting (see Risk Monitoring and Reporting below). Risk Integration also regularly provides reports to the supervisory section of the CNB.

Risk Integration is also responsible for preparation of recovery plans and cooperates with regulator in preparation of resolution plan.

### *Delegation of responsibilities*

The Board of Directors has delegated responsibilities to each of the RCOC and the CRO. Such delegated authority includes the following:

- the RCOC may authorize transactions and approve risk limit exceptions described in limit book and limit book framework. The limit book and limit book framework is regularly approved by RCOC and Board of Directors.



In addition, in instances where amounts cannot be calculated or for which there is uncertainty over the exact risk exposure, the CRO may decide to submit the transaction to the RCOC.

- an authorization of the CRO is required for decisions on risk frameworks and policies:
  - (i) where the risk frameworks or policies impact 5% or more of the ČSOB Group's regulatory capital by risk type or a derivation thereof; and
  - (ii) where, if the regulatory capital cannot be taken as a relevant measure, the risk framework or policy impacts 2% of the ČSOB Group's estimated sustainable profit for the current year.
- to the CRO, the authority to decide on matters falling below the thresholds described above. The CRO may sub-delegate this authority further to one of the departments forming the Risk Function.

Moreover, the CRO may submit to the Board of Directors, the Supervisory Board the Risk and Compliance Committee and/or the Audit Committee issues and concerns related to the entire ČSOB which the CRO considers to have an actual or potential material impact on ČSOB's risk parameters.

#### ***Other Departments and Committees Participating in Risk and Capital Management***

In addition to the Board of Directors, the Audit Committee, the Supervisory Board, the RCOC, the CRO and the Risk Function, the following other departments and committees are involved in day-to-day risk and capital management at the ČSOB level:

##### ***Credit Departments***

The Credit Departments are responsible for implementing and maintaining the individual credit processes within the frameworks designed by the Risk Function and the limits determined by the risk appetite and capital allocation approved by the Board of Directors. ČSOB has two Credit Departments, one for each of:

- (i) corporates, SMEs and banks;
- (ii) consumer finance;

These departments report either to a Credit Risk Manager or the CFO. The key responsibilities of the Credits Departments are to:

- (i) approve individual credit applications;
- (ii) approve contractual documentation concerning individual credits;
- (iii) monitor credit behaviour of individual credits during their lifetime; and
- (iv) manage the work-out process in respect of individual credits.

##### ***Asset and Liability Management Department (ALMD)***

The ALMD is responsible for managing the assets and liabilities of ČSOB's investment portfolio within the frameworks designed by the Risk Function and the risk appetite and capital allocation approved by the Board of Directors. The ALMD is also primarily responsible for managing the funding and liquidity position of ČSOB. The ALMD reports to the CFO.

##### ***Internal Audit Department***

The Internal Audit Department regularly audits risk / assesses capital management processes throughout ČSOB examining both the adequacy of its risk and capital management procedures and the Bank's compliance with the same. The Internal Audit Department discusses the results of its assessments with management, and reports its findings and recommendations to the Board of Directors and the Audit Committee. The Internal Audit Department reports to the CEO.

### *New and Active Product Processes (NAPPs)*

Members of NAPPs process are responsible for the approval of new products and their distribution and marketing, as well as for the regular review of existing products. Cross functional membership in NAPPs including control functions (the Risk Function, Finance Department, Tax Department, Legal Department, Compliance Department and Internal Audit Department) seeks to ensure that no product may be offered to ČSOB's customers unless all significant risks have been analysed and mitigated and residual risks have been accepted. ČSOB pays special attention to protecting ČSOB against claims arising from the mis-selling of products. As a general rule, all products as well as all distribution channels must be covered by a NAPP.

### *Credit Sanctioning Committee (CSC)*

The CSC is a committee with group-wide responsibility and authority to take decisions on individual credit applications falling within the delegated decision powers of the CSC. As such, it acts as the highest decision-making committee for the ČSOB Group with respect to credit risk. The members of the CSC are the CFO, who is the CSC's chairman, and the head of ČSOB credit and bad debts department, corporate advice and underwriting department, corporate and bank credits department, corporate specialised finance department and corporate and institutional banking department. The CSC reports to the Board of Directors.

### *Business Risk Meetings (BRMs)*

Business Risk Meetings are established for each business line in the Bank where business specific risk issues are regularly discussed. The CRO has sole decision right within the delegated decision authority which can always be escalated to the Board of Directors at the request of the Board of Directors' member responsible for that area.

### *Internal Capital Adequacy Assessment Process (ICAAP)*

The Basel Capital Accord, generally referred to as Basel II, was the first to present, a qualitatively new dimension of requirements for capital adequacy assessment at banks and other credit institutions known as the Second Pillar.

Pillar 2, inter alia, requires the institution to internally assess its capital adequacy taking into account all (material) risks it faces or may face (Internal Capital Adequacy Assessment Process – ICAAP). Basel III changed the regulatory Pillar 2 practices mainly in the area of capital planning, stress testing and risk strategies.

The ICAAP is seen as an integral part of the overall management and control system of the Bank, by which ČSOB also adopts and uses reliable, effective and comprehensive strategies and procedures to:

- continually set and assess the need for internal capital; and
- plan and maintain internal capital resources, of the amount, structure and allocation to sufficiently cover the risks that ČSOB is or may be exposed to (internally set and maintained capital adequacy).

As part of the KBC Group, ČSOB has adopted a unified KBC Group ICAAP approach, approved by the top managements of both KBC and ČSOB, taking into account requirements of the home regulator (the Czech National Bank) as well as the host regulator (the European Central Bank).

In 2015, KBC developed a new internal economic capital model, which was also adopted by the Bank. The main difference between the previous and the current models is the change from fully fair value based approach to accounting value based approach. The new model was developed taking into account the IFRS 9, which will be implemented in 2018.

Regularly, at least once a year, the Board of Directors evaluates the ICAAP, focusing on an overall assessment of whether the strategies and procedures used are reliable, effective, comprehensive and still proportionate to the nature, scale and complexity of the Bank's activities. The Board of Directors also discusses and approves any ICAAP changes and modifications. Moreover, results of Internal Capital Model which is currently used for internal calculation of the ČSOB capital adequacy are quarterly reported to the Board of Directors.

When setting and assessing - on an ongoing basis - its internal capital needs, and planning and maintaining its internal capital resources, ČSOB uses an accounting-value approach, while taking into account quantitative and qualitative inputs and methods, including its own expert analyses, forecasts and scenarios proportionate to the nature, scale and complexity of its activities and the risks associated with them.

ICAAP is forward-looking, i.e. it also takes into account the risks to which the Bank will or may be exposed. Therefore, ČSOB also assesses and takes into account, under the ICAAP the following:

- the processes of planning, preparing and approving new activities, products or systems;
- other ongoing or anticipated material changes in its risk profile or in the external environment;
- effects of possible divergences from the anticipated developments, including the effects of possible extraordinary circumstances; and
- stress test results.

including the methods of reflecting these when planning and securing internal capital resources. The ICAAP strategic planning horizon is three years.

The amount of capital needed is determined using the economic capital method and addresses the following material risks to which the Bank is or may be exposed:

- Credit and counterparty risk, (including concentration risk)
- Interest rate in banking book
- Market risk banking book (excl. interest rate)
- Market risk trading book
- Operational risk
- Funding and liquidity risk

A relevant amount of economic capital is allocated directly to these types of risk. Other risks, such as liquidity risk, strategic risk and reputational risk, are covered, under ICAAP processes, by qualitative measures in risk management, organisation of processes, control mechanisms, etc.

The amount of capital needed is calculated for the ČSOB Group as a separate entity within the KBC Group at the probability level of 99.9% for a one year period, taking into account relevant diversification effects. The internally defined capital resources must fully cover the total capital need and, if compliance with this condition was at risk, ČSOB, in cooperation with the KBC Group, would take relevant remedial measures (increasing capital resources, reducing risk, etc.).

#### **Risk measurement and reporting systems**

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise when extreme events that are unlikely to occur do, in fact, occur.

Monitoring and controlling of risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all businesses is examined and processed in order to analyse, control and identify risks when they arise. This information is presented and explained to the Board of Directors, the RCOC, and the CRO. The reports include aggregate credit exposure, credit metric forecasts, hold limit exceptions, Value at Risk (VaR), interest rate sensitivities, interest rate gaps, liquidity ratios and risk profile changes. Once a quarter, the Supervisory Board receives a comprehensive risk report designed to provide all information necessary to assess and conclude on the risks of the Bank.

A daily report is provided to the top management and all other relevant members of the Bank on the use of market limits and analysis of VaR in the trading book. A weekly report is provided to top management and all other relevant members on interest rate sensitivities and liquidity in the non-trading book.

### **Risk mitigation**

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Bank. The effectiveness of hedges is assessed by the Middle Office. The effectiveness of all hedge relationships is monitored by the unit quarterly. In situations of ineffectiveness, a new hedge relationship to mitigate risk on a continuous basis is established.

### **Excessive risk concentration**

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. To prevent and manage excessive risk concentration at both a relationship and industry level, the Bank, for selected cases, uses credit risk transfer instruments (e.g. risk sharing participation, risk transfer guarantees, etc).

## **38.2 Credit risk**

Credit risk is the risk of a potential loss expected to arise as a consequence of the non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to a commercial transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay, or to events or measures taken by the political or monetary authorities of a particular country. The latter is also referred to as country risk.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations. The Bank monitors exposures in relation to these limits. The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties. This includes also regular collateral revisions.

Since September 2012, the Bank is allowed by both Belgian and Czech banking regulators to use the IRB Advanced approach for the capital calculations of its non-retail (Corporate, non-retail SME, Banks, Non-Banking financial institutions) as well as retail exposures. As a result, credit risk is measured, monitored and managed based on the principles of this approach.

For the non-retail exposure (Corporate, non-retail SME, Banks, Non-Banking financial institutions), counterparty risk (i.e. default risk) is managed based on statistical default prediction models that establish a rating (PD / Probability of Default), LGD (Loss Given Default) and EAD (Exposure at Default).

For the retail exposures, statistical models have been developed for PD, LGD and EAD. Contrary to the non-retail exposure, where risk factors are determined on an individual basis, risk factors are determined in Retail based on risk-homogenous sets of exposure (so-called pools).

The model results are used for the capital calculation and for credit decision purposes too.

The default is defined as a situation where at least one of the following conditions is met:

- (i) it may be assumed that the customer will not fulfil its obligations in a proper and timely manner without ČSOB seeking to collect its outstanding receivable through credit protection,
- (ii) at least one payment of the principal or interest and fees of any obligation of the customer towards ČSOB is more than 90 days past the due date.

At ČSOB, default status is determined to occur any time a forbearance measure-concession is granted: forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. For more, see the section “Forbearance measures”.

### Non-retail exposure

*Rating system: PD (Probability of Default)*

The Bank manages its non-retail credit exposure by establishing counterparty limits that are based on individually assigned internal ratings. These ratings are based on IRB Advanced compliant statistical rating models that take into account financial and non-financial data. The individual PD rating is scaled according to the KBC master scale, which has 12 grades going from PD 1 - the best rating to PD 12, which is the worst.

PD 1 to PD 9 represent the performing exposures.

PD 10 contains: (i) customers where the relevant Bank credit decision authority has judged the exposure to be “unlikely to pay” and none of the obligations are more than 90 days overdue, and (ii) restructured loans. After at least twelve months of performance, the restructured loan may be reclassified to the performing status; and (iii) previously restructured loans already classified as performing less than two years ago which become more than 30 days overdue.

PD 11 represent customers, who have been overdue for 90 days or more, but not subject to bankruptcy proceedings yet.

PD 12 represents customers, which are subject to bankruptcy proceeding or Bank credit decision authority has judged the exposure to be “partly or fully lost” without recourse to credit protection.

PD ratings are used not only for the measurement, monitoring and management of credit risk, but also to determine, among other things, the level at which a credit approval must be obtained, the required collateral and pricing.

The following table sets forth a breakdown of the Bank’s risk categories, including the internal and external ratings, for non-retail exposure, and their comparison to the CNB’s risk categories:

PD Scale	ČSOB risk categories for Non-retail exposure				ČSOB and CNB risk categories	CNB risk categories
	PD Rating	S&P Rating	Performance	Impairment		
Normal	1-7	AAA - B	Performing customers	Collectively assessed	Non-defaulted	Standard
Asset Quality review (AQR)	8-9	B- - C	Performing customers	Collectively assessed	Non-defaulted	Watched
Uncertain	10	D	Non-performing customers	Individually impaired	Defaulted	Substandard
Uncertain	11	D	Non-performing customers	Individually impaired	Defaulted	Doubtful
Irrecoverable	12	D	Non-performing customers	Individually impaired	Defaulted	Loss

### Individual Credit Processes

The individual approval, monitoring and work-out processes are subject to risk and capital management frameworks approved by the Group Risk Management (GRM) and/or the CRO but developed, maintained and implemented by the Credit Departments in the Bank. These Credit Departments are also responsible for the implementation of these frameworks in the day-to-day operations of the credit processes and for assuring that individual risk acceptance remains within the limits set by the risk appetite statement.

### *Application Process*

The loan or credit application process for non-retail credit exposures involves three steps. Firstly, the employee maintaining the overall relationship with the customer prepares a credit application containing the credit request, the reason for the application and an analysis of the risks (including a financial analysis). Secondly, a credit risk advisor operating independently from the business line, who reports to the Credit Department, provides a written non-binding advice. Thirdly, a decision is taken by the Credit Sanctioning Committee (CSC), the highest local decision taking body, or one of its sub-committees consisting of business line employees and employees in the Credit Department. The Committee adopts its decisions by consensus based on a draft decision formulated by the Chairman or Vice - Chairman.

Within the delegation framework set by the Bank, the Credit Department can delegate the credit decision to the regional manager or senior relationship manager of a branch. Delegations are granted *ad personam*. The delegations are risk based and take into account the total exposure with respect to a customer or customer group.

All credit decisions must be taken according to the "four eyes principle", i.e. at least two persons need to be involved.

### *Individual Monitoring Process*

An individual credit monitoring process is applicable to all non-retail exposures. Credit exposures with a rating between PD 1 – 8 (non-retail SME) / PD 1 – 9 (corporate) are reviewed by the business function with the support of monitoring applications. Credit exposures with a rating between PD 9 – 12 (non-retail SME) / PD 10 – 12 (corporate) are reviewed by the Bad Debt Department, which is a sub-department of the Credit Departments.

Regardless of the PD rating, a full credit application must be submitted to the applicable decision authority for a review at least once a year in accordance with the same application process as for the new exposures. Additionally, certain triggers lead to a more frequent review of credit applications. These triggers include breaches of contractual conditions (such as the breach of financial or non-financial covenants or the non-payment of fees, interest or principal), but also events that do not constitute a breach of contract such as a sudden unexpected change in management that could lead to a deterioration of the customer's financial situation.

In addition to the annual review process, commercial real estate finance, acquisition finance and project finance are subject to a quarterly review by the CSC, pursuant to which all major exposure is subjected to a short review of its main credit risk characteristics. Based on the outcome of the general quarterly review, the CSC can take immediate action or request an early full review of the file.

### *Collective Monitoring Process*

In addition to the required annual review process, a collective monitoring process is applied to non-retail SME customers. The monitoring of compliance by the customer with covenants specified in the relevant financing documentation is based on information provided by the customer in covenant compliance reports and financial statements. A breach of the internal thresholds and covenants specified in the financing documentation triggers the individual review process as described above.

### *Bad Debts Treatment*

For both corporate and non-retail SME customers, the management of bad debts is the sole responsibility of the Bad Debt Department. The credit customer relationship is transferred to the Bad Debt Department when an exposure reaches a PD rating of 9 in the case of non-retail SME and PD rating of 10, in the case of corporate customers.



## Retail exposure (Entrepreneurs, retail SMEs and Individuals)

### Risk Categories

The following table sets forth a breakdown of the Bank's risk categories for retail exposure and their comparison to the CNB's risk categories:

PD Scale	ČSOB risk categories for Retail exposure			ČSOB and CNB risk categories	CNB risk categories
	Days overdue	Performance	Impairment		
Normal	0 - 30	Performing	Collectively assessed	Non-defaulted	Standard
Asset Quality review (AQR)	31 - 90	Performing	Collectively assessed	Non-defaulted	Watched
Uncertain	91 - 180	Non-performing	Individually impaired	Defaulted	Substandard
Uncertain	181 - 360	Non-performing	Individually impaired	Defaulted	Doubtful
Irrecoverable	360 and more	Non-performing	Individually impaired	Defaulted	Loss

In addition, all restructured exposures fall initially within the non-performing category irrespective of whether or not they are overdue. After at least twelve months of performance the restructured exposures may be reclassified to the performing status. Previously restructured exposures already classified as performing less than two years ago, can fall again into non-performing category when becoming more than 30 days overdue.

### Application Process

The application process in the retail segment is based on the usage of application scorecards for new customers and behavioural scorecards for existing customers. For consumer finance products (personal unsecured loans, retail overdrafts and credit cards) decisions are fully automated based on scorecards in the vast majority of cases. Mortgage decisions are supported by scorecards but decision-taking is essentially manual.

The application process makes extensive use of several external credit bureau databases that include both positive and negative information.

### Monitoring Process

The monitoring process in the retail segment is performed regularly by the relevant Credit Departments and the GRM. It is based on aggregated data. It does not involve individual reviews and looks at the development of defaults and probability of default within different sub-portfolios and the development of Credit Cost Ratios within the different sub-portfolios.

### Collection Process

The collection process in retail consumer finance consists of two major phases: early collection and late collection. Early collection is generally based on a rapid succession of reminders (via a call centre or automated written notices) starting when any payment is three days overdue and may involve the restructuring of the loan. Late collection starts when any payment is 90 days overdue, and is focused on legal proceedings. All collection units within the Bank are monitored by the Risk Function.

### Derivative financial instruments

Positive fair values arising from financial derivative instruments entered into by the Bank, such as foreign exchange derivatives and interest rate swaps, give rise to potential future claims resulting from counterparty default and are therefore treated for credit risk purposes in the same way as credit exposures.



### Credit-related commitments risk

The Bank provides guarantees and letters of credit on behalf of its customers, as a result of which the Bank may be required to make payments on such customers' behalf. Such payments are subsequently required to be reimbursed to ČSOB by the customer based on the terms of the underlying credit documentation. These guarantees expose the Bank to similar risks as loans and such risks are managed using the same credit risks control processes and policies.

The following two main commitment risks are treated as off-balance sheet within the Bank:

- (i) *Undrawn but Committed Exposure*. This exposure arises when the Bank has a legal commitment to provide a borrower with a facility or credit when asked and such facility or credit has not yet been drawn. This type of exposure comprises to a large extent of short-term exposure, where the Bank's commitment has a duration equal to or shorter than one year.
- (ii) *Off-Balance Sheet Products*. This exposure consists of bank guarantees and/or letters of credit. Off-balance sheet products are granted predominantly in the corporate segment and often consist of bid, performance or advance payment bonds for domestic construction companies.

Commitment risks expose the Bank to similar risks as loans and such risks are monitored and managed using the same credit risk control processes and policies.

The Bank manages credit risk in three major portfolios: Credit portfolio, Investment portfolio and Trading portfolio. Besides these there is a credit exposure connected with settlement activities (correspondent banking, settlement of receivables generated within system of electronic toll, which ČSOB administers for the Czech Government – e-Toll), where risk is limited as counterparties are either highly rated banks, government institutions or entities with guarantees by highly rated banks.

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2016. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

(CZK m)	Credits	Investment	Trading	Other assets	Total
<b>ASSETS</b>					
Cash and balances with central banks (Note: 14)	-	46,846	-	-	46,846
Financial assets held for trading	-	839	20,877	-	21,716
Financial assets designated at fair value through profit or loss	-	3,485	-	-	3,485
Available-for-sale financial assets	2,487	70,580	-	-	73,067
Loans and receivables	245,665	449,493	-	3,582	698,740
Fair value adjustments of the hedged items in portfolio hedge	-	797	-	-	797
Held-to-maturity investments	833	131,846	-	-	132,679
Derivatives used for hedging	-	11,623	-	-	11,623
Other assets (Note: 23)	-	-	-	792	792
<b>Total</b>	<b>248,985</b>	<b>715,509</b>	<b>20,877</b>	<b>4,374</b>	<b>989,745</b>
Contingent liabilities (Note: 33)	31,329	2,006	-	-	33,335
Commitments – irrevocable (Note: 33)	94,110	1,081	-	-	95,191
<b>Total</b>	<b>125,439</b>	<b>3,087</b>	<b>-</b>	<b>-</b>	<b>128,526</b>
<b>Total credit risk exposure</b>	<b>374,424</b>	<b>718,596</b>	<b>20,877</b>	<b>4,374</b>	<b>1,118,271</b>

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2015. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

(CZKm)	Credits	Investment	Trading	Other assets	Total
<b>ASSETS</b>					
Cash and balances with central banks (Note: 14)	-	107,076	-	-	107,076
Financial assets held for trading	-	661	29,990	-	30,651
Financial assets designated at fair value through profit or loss	-	3,491	-	-	3,491
Available-for-sale financial assets	2,245	72,144	-	-	74,389
Loans and receivables	235,969	262,928	-	2,771	501,668
Fair value adjustments of the hedged items in portfolio hedge	-	866	-	-	866
Held-to-maturity investments	1,333	135,099	-	-	136,432
Derivatives used for hedging	-	11,906	-	-	11,906
Other assets (Note: 23)	-	-	-	898	898
<b>Total</b>	<b>239,547</b>	<b>594,171</b>	<b>29,990</b>	<b>3,669</b>	<b>867,377</b>
Contingent liabilities (Note: 33)	29,387	-	-	-	29,387
Commitments – irrevocable (Note: 33)	90,440	869	-	-	91,309
<b>Total</b>	<b>119,827</b>	<b>869</b>	<b>-</b>	<b>-</b>	<b>120,696</b>
<b>Total credit risk exposure</b>	<b>359,374</b>	<b>595,040</b>	<b>29,990</b>	<b>3,669</b>	<b>988,073</b>

Where financial instruments are recorded at fair value the amounts shown above represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Set out below is an analysis of the maximum exposure to credit risk of the Bank before and after taking into account the collateral held:

(CZKm)	2016			2015		
	Gross maximum exposure	Financial effect of collateral	Net maximum exposure	Gross maximum exposure	Financial effect of collateral	Net maximum exposure
<b>ASSETS</b>						
Cash and balances with central banks (Note: 14)	46,846	-	46,846	107,076	-	107,076
Financial assets held for trading	21,716	669	21,047	30,651	478	30,173
Financial assets designated at fair value through profit or loss	3,485	-	3,485	3,491	-	3,491
Available-for-sale financial assets	73,067	-	73,067	74,389	-	74,389
Loans and receivables	698,740	341,020	357,720	501,668	171,196	330,472
Fair value adjustments of the hedged items in portfolio hedge	797	-	797	866	-	866
Held-to-maturity investments	132,679	-	132,679	136,432	-	136,432
Derivatives used for hedging	11,623	791	10,832	11,906	782	11,124
Other assets (Note: 23)	792	-	792	898	-	898
<b>Total</b>	<b>989,745</b>	<b>342,480</b>	<b>647,265</b>	<b>867,377</b>	<b>172,456</b>	<b>694,921</b>
Contingent liabilities and commitments – irrevocable (Note: 33)	128,526	34,881	93,645	120,696	30,160	90,536
<b>Total credit risk exposure</b>	<b>1,118,271</b>	<b>377,361</b>	<b>740,910</b>	<b>988,073</b>	<b>202,616</b>	<b>785,457</b>

Financial effect of collateral represents a fair value of collateral received by the Bank against a credit exposure limited to the outstanding amount of the exposure.

The portfolios are further structured as follows:

The credit portfolio is structured according to the type of the business the Bank enters into:

2016 (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Granted exposure	Allowances	Provisions	Net exposure
Corporate	149,098	27,668	54,296	231,062	(1,851)	(85)	229,126
SME	82,271	3,418	29,984	115,673	(3,674)	(118)	111,881
Retail	24,183	16	9,635	33,834	(1,043)	(17)	32,774
Other	28	459	195	682	(27)	(12)	643
<b>Total credits</b>	<b>255,580</b>	<b>31,561</b>	<b>94,110</b>	<b>381,251</b>	<b>(6,595)</b>	<b>(232)</b>	<b>374,424</b>
2015 (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Granted exposure	Allowances	Provisions	Net exposure
Corporate	145,051	25,827	53,773	224,651	(1,960)	(69)	222,622
SME	81,073	2,951	27,841	111,865	(3,804)	(86)	107,975
Retail	20,333	10	8,743	29,086	(1,183)	(15)	27,888
Other	68	884	83	1,035	(31)	(115)	889
<b>Total credits</b>	<b>246,525</b>	<b>29,672</b>	<b>90,440</b>	<b>366,637</b>	<b>(6,978)</b>	<b>(285)</b>	<b>359,374</b>

An industry sector analysis of the Bank's Credit portfolio, before taking into account any collateral held or other credit enhancements, is as follows:

Sector	2016		2015	
	Granted exposure (CZKm)	Percentage of total exposure	Granted exposure (CZKm)	Percentage of total exposure
Services	57,807	15.2	55,429	15.1
Distribution	52,622	13.8	51,035	13.9
Commercial Real Estate	46,381	12.2	35,011	9.6
Building and Construction	34,253	9.0	30,329	8.3
Private persons	30,744	8.1	26,095	7.1
Automotive	29,238	7.7	28,988	7.9
Oil, Gas and other Fuels	19,734	5.2	20,346	5.6
Machinery and Heavy Equipment	15,253	4.0	15,804	4.3
Electricity	14,762	3.9	15,215	4.1
Authorities	13,408	3.5	16,853	4.6
Metals	11,728	3.1	12,159	3.3
Finance and Insurance	10,409	2.7	12,144	3.3
Chemicals	7,558	2.0	5,650	1.5
Electrotechnics	7,120	1.9	6,482	1.8
Food producers	5,505	1.4	4,870	1.3
Telecommunications	2,823	0.7	8,366	2.3
Other sectors	21,906	5.6	21,861	6.0
<b>Total</b>	<b>381,251</b>	<b>100.0</b>	<b>366,637</b>	<b>100.0</b>

The investment portfolio is structured according to the type of the instrument:

2016 (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Cumulative impairment loss	Granted exposure
Debt securities	205,569	-	-	-	<b>205,569</b>
Equity securities	392	-	-	(50)	<b>342</b>
Loans and receivables within investment portfolio	450,290	2,006	1,081	-	<b>453,377</b>
Derivatives used for hedging	11,623	-	-	-	<b>11,623</b>
Derivatives held for trading	839	-	-	-	<b>839</b>
Cash and balances with central banks	46,846	-	-	-	<b>46,846</b>
<b>Total investment</b>	<b>715,559</b>	<b>2,006</b>	<b>1,081</b>	<b>(50)</b>	<b>718,596</b>
2015 (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Cumulative impairment loss	Granted exposure
Debt securities	209,430	-	-	-	<b>209,430</b>
Equity securities	1,383	-	-	(79)	<b>1,304</b>
Loans and receivables within investment portfolio	263,794	-	869	-	<b>264,663</b>
Derivatives used for hedging	11,906	-	-	-	<b>11,906</b>
Derivatives held for trading	661	-	-	-	<b>661</b>
Cash and balances with central banks	107,076	-	-	-	<b>107,076</b>
<b>Total investment</b>	<b>594,250</b>	<b>-</b>	<b>869</b>	<b>(79)</b>	<b>595,040</b>

The investment portfolio is monitored from a counterparty sector point of view:

Sector	2016		2015	
	Granted exposure (CZKm)	Percentage of total exposure	Granted exposure (CZKm)	Percentage of total exposure
Central banks	281,849	39.2	177,077	29.8
General government	169,095	23.5	171,756	28.9
Credit institutions	235,750	32.8	213,405	35.8
Corporate	31,902	4.5	32,802	5.5
<b>Total investment</b>	<b>718,596</b>	<b>100.0</b>	<b>595,040</b>	<b>100.0</b>

The trading portfolio is structured according to the type of the instrument:

2016 (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Granted exposure
Debt securities	8,683	-	-	8,683
Loans and advances	15	-	-	15
Derivatives held for trading	12,179	-	-	12,179
<b>Total trading portfolio</b>	<b>20,877</b>	<b>-</b>	<b>-</b>	<b>20,877</b>
2015 (CZKm)	Outstanding gross amount	Contingent liabilities gross	Credit commitments gross	Granted exposure
Debt securities	19,130	-	-	19,130
Derivatives held for trading	10,860	-	-	10,860
<b>Total trading portfolio</b>	<b>29,990</b>	<b>-</b>	<b>-</b>	<b>29,990</b>

The trading portfolio is monitored from counterparty sector point of view:

Sector	2016		2015	
	Granted exposure (CZKm)	Percentage of total exposure	Granted exposure (CZKm)	Percentage of total exposure
General government	4,527	21,7	13,270	44.3
Credit institutions	11,776	56,4	11,761	39.2
Corporate	4,574	21,9	4,959	16.5
<b>Total trading portfolio</b>	<b>20,877</b>	<b>100,0</b>	<b>29,990</b>	<b>100.0</b>

### Risk concentrations of the maximum exposure to credit risk

The concentration of risk is managed by geographical region, industry and by client/counterparty. The Bank's financial assets, before taking into account any collateral held or other credit enhancements can be analysed by the following geographical regions:

(CZK m)	2016		2015	
	Total risk	of which General government	Total risk	of which General government
Czech Republic	1,042,852	160,207	912,983	174,340
Slovak Republic	15,796	8,041	14,833	7,441
Greece	1	-	1	-
Italy	2,609	-	5,016	-
Spain	68	-	288	-
Belgium	14,222	1,835	14,151	2,438
Hungary	594	-	658	-
Other Europe	37,929	10,661	39,883	10,371
Other	4,200	-	2,760	-
<b>Total</b>	<b>1,118,271</b>	<b>180,744</b>	<b>990,573</b>	<b>194,590</b>

Client concentration is monitored on the level of individual portfolios. In the credit portfolio the exposure towards groups of economically connected subjects are monitored:

Client	2016		2015	
	Granted exposure (CZK m)	% of total credit portfolio	Granted exposure (CZK m)	% of total credit portfolio
1 largest client	8,411	2.2	8,258	2.3
10 largest clients	55,795	14.6	53,391	14.6
25 largest clients	95,914	25.4	91,305	24.9

The largest exposures to single clients in the investment portfolio as at 31 December 2016 and 31 December 2015 were:

Client	2016		2015	
	Granted exposure (CZK m)	% of total investment portfolio	Granted exposure (CZK m)	% of total investment portfolio
CNB	281,849	39.2	177,077	29.8
Hypoteční banka	202,846	28.2	179,866	30.2
Czech Ministry of Finance (S&P's rating AA)	148,558	20.7	151,528	25.5

The largest exposures to single clients in the trading portfolio as at 31 December 2016 and 31 December 2015 were:

Client	2016		2015	
	Granted exposure (CZK m)	% of total trading portfolio	Granted exposure (CZK m)	% of total trading portfolio
Czech Ministry of Finance (S&P's rating AA)	4,527	21.7	13,269	44.2
KBC Bank	2,928	14.0	2,685	9.0

### Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For securities lending and reverse repurchase transactions, cash or securities;
- For commercial lending, pledges over real estate properties, trade receivables and inventory;
- For retail lending, pledges over residential properties are used for mortgage financing.

The Bank continuously monitors the market value of all collateral, monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses and requests additional collateral in accordance with the underlying agreement when necessary. The amount of collateral reported for an individual receivable does not exceed the carrying amount of the receivable.

Within concluding derivatives transaction to hedge counterparty's risk the Bank uses Master netting agreements and collateralisation annex (i.e. CSA or its equivalents).

### Impairment assessment

The main considerations for credit impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, worsening of their credibility reflected by credit rating downgrades or infringement of the original terms of the contract. The Bank addresses impairment in two areas: specific impairments and impairments incurred but not reported (IBNR).

Specific impairments are applied to individual assets where there is registered objective evidence of default. All defaulted exposure requires an impairment test – when a client becomes defaulted, it is considered to be impaired and thus specific impairment has to be accounted for. IBNR are applied for asset groups that based on statistical evidence contain probably already impaired assets, but have not been yet individually recognised.

#### *Specific impairment (Individual assessment)*

The Bank determines allowances appropriate for loans with outstanding amounts above a predefined materiality threshold where there is registered objective evidence of default on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of other financial support, liquidation value of collateral, and the timing of the expected cash flows. Impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention. For insignificant exposures with registered objective evidence of default a portfolio approach for deriving the impairment allowance is applied using statistical methods and models.

#### *IBNR (Collective assessment)*

Collective allowances are applied for loans and advances where there has not yet been recognised objective evidence of impairment and they reflect impairment that is likely to be present in the group of assets. Collective allowances are assessed based on statistical estimates and evaluated at each reporting period.

Collective allowances are estimated by taking into consideration:

- (i) historical losses in the portfolio;
- (ii) current economic conditions;
- (iii) the approximate delay between the time a loss is likely to have been incurred and the time it will be identified (emergence period).



The local management is responsible for deciding the length of the emergence period. In 2014, the Bank used a uniform emergence period of four months, which was confirmed by the back-testing. In 2015, the emergence period has been extended to 6 – 8 months for some of the segments based on the latest back-testing results and in 2016 further changes have been made for other segments, prolonging the emergence period also to 8 months. The emergence period extension resulted in 2016 and 2015 an increase of the collective impairment provision of CZK 160 m (2015: CZK 155 m). The back-testing methodology was refined in 2016 and 2015 following the updated Bank policy on determining the emergence period and its back-testing.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as allowances for loans and other receivables.

### Quality of credit portfolio

The Bank sorts exposures into five categories for the purpose of credit risk management. The table below shows the credit quality by class of asset for loan-related statement of financial position lines (in gross amounts), based on the Bank's credit rating system as at 31 December 2016 and 2015 by individual portfolios:

Credit portfolio (CZKm)	2016					Total
	Collectively assessed assets		Individually impaired assets			
	Normal	AQR	Uncertain (Substandard)	Uncertain (Doubtful)	Irrecoverable	
Corporate	141,421	4,240	1,892	-	1,545	149,098
SME	75,526	2,112	1,416	338	2,879	82,271
Retail	22,994	141	62	201	785	24,183
Other	3	-	-	1	24	28
<b>Total</b>	<b>239,944</b>	<b>6,493</b>	<b>3,370</b>	<b>540</b>	<b>5,233</b>	<b>255,580</b>

Credit portfolio (CZKm)	2015					Total
	Collectively assessed assets		Individually impaired assets			
	Normal	AQR	Uncertain (Substandard)	Uncertain (Doubtful)	Irrecoverable	
Corporate	138,574	2,673	1,936	221	1,647	145,051
SME	73,905	2,066	1,476	371	3,255	81,073
Retail	18,902	158	176	220	877	20,333
Other	36	-	3	-	29	68
<b>Total</b>	<b>231,417</b>	<b>4,897</b>	<b>3,591</b>	<b>812</b>	<b>5,808</b>	<b>246,525</b>

Investment portfolio (CZKm)	2016		Total
	Collectively assessed assets	Individually impaired assets	
	Normal	Irrecoverable	
Debt securities	205,569	-	205,569
Equity securities	341	1	342
Loans and receivables within investment portfolio	453,377	-	453,377
Derivatives used for hedging	11,623	-	11,623
Derivative contracts held for trading	839	-	839
Cash and balances with central banks	46,846	-	46,846
<b>Total</b>	<b>718,595</b>	<b>1</b>	<b>718,596</b>

**Investment portfolio**

(CZKm)	2015		
	Collectively assessed assets	Individually impaired assets	Total
	Normal	Irrecoverable	
Debt securities	209,430	-	<b>209,430</b>
Equity securities	1,303	1	<b>1,304</b>
Loans and receivables within investment portfolio	264,663	-	<b>264,663</b>
Derivatives used for hedging	11,906	-	<b>11,906</b>
Derivative contracts held for trading	661	-	<b>661</b>
Cash and balances with central banks	107,076	-	<b>107,076</b>
<b>Total</b>	<b>595,039</b>	<b>1</b>	<b>595,040</b>

**Trading portfolio**

(CZKm)	2016		
	Collectively assessed assets	Individually impaired assets	Total
	Normal	Irrecoverable	
Debt securities	8,683	-	8,683
Loans and advances	15	-	15
Derivative contracts held for trading	12,179	-	12,179
<b>Total</b>	<b>20,877</b>	<b>-</b>	<b>20,877</b>

**Trading portfolio**

(CZKm)	2015		
	Collectively assessed assets	Individually impaired assets	Total
	Normal	Irrecoverable	
Debt securities	19,130	-	19,130
Derivative contracts held for trading	10,860	-	10,860
<b>Total</b>	<b>29,990</b>	<b>-</b>	<b>29,990</b>

The table below shows a credit quality analysis of gross exposures of collectively assessed financial assets in the Credit portfolio:

(CZKm)	2016			2015		
	Neither past due nor individually impaired	Past due (< 30 days) but not individually impaired	Past due (> 30 days) but not individually impaired	Neither past due nor individually impaired	Past due (< 30 days) but not individually impaired	Past due (> 30 days) but not individually impaired
Corporate	145,661	-	-	141,247	-	-
SME	76,613	956	69	75,583	325	63
Retail	22,549	504	82	18,606	379	75
Other	3	-	-	36	-	-
<b>Total</b>	<b>244,826</b>	<b>1,460</b>	<b>151</b>	<b>235,472</b>	<b>704</b>	<b>138</b>

Collectively assessed assets reported within Neither past due nor individually impaired gross exposures consist of Normal risk category assets based on the Bank's credit ranking system.

There were no past due but not impaired assets in the Investment and Trading portfolios.

Gross amounts of individually impaired financial assets included in the credit portfolio and the related impairment are as follows:

(CZKm)	2016		2015	
	Gross amount	Impairment	Gross amount	Impairment
Credit portfolio				
Corporate	3,437	(1,767)	3,804	(1,887)
SME	4,633	(3,336)	5,102	(3,605)
Retail	1,048	(799)	1,273	(963)
Other	25	(25)	32	(31)
<b>Total</b>	<b>9,143</b>	<b>(5,927)</b>	<b>10,211</b>	<b>(6,486)</b>

Individually impaired financial assets included in the investment portfolio in the carrying amounts are as follows:

(CZKm)	2016	2015
Equity securities	1	1

### Forbearance measures

Based on the new guidelines on non-performing exposures and forbearance measures laid down by the European Banking Authority, which came into effect on 30 September 2014, the Bank implemented a new definition of forborne loans in 2014.

Forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. Contracts for which forbearance measures have been taken and for which the exit criteria are not fulfilled are referred to as "Forborne credits". Such an approach enables the Bank to control and limit potential future losses stemming from troubled credits.

As a result of the update of the Definition of Default made by the Bank, the Bank's definition of default is now aligned with the EBA definition of non-performing exposures (PD 10-11-12), meaning that from 2014 they are only to be seen as synonyms. Previously, only PD grades 11 and 12 fell within the "non-performing" exposure category. The same holds for the definition of the individually impaired financial instrument according to IFRS.

The approved changes impacted the business of the Bank in the following way. The minimum period for the default status for the forborne exposures has been extended from 6 to 12 months; following the conservative approach of the local regulator, default status occurs any time a forbearance measure-concession is granted. The minimum period for assignment of the "Forborne tag" is therefore 36 months: this period consists of the 12 months of the default status, and 24 months of what is referred to as the "probation period". In addition, any time more than 30 days past due are observed at an individual receivable during the "probation period", the receivable is re-classified as defaulted and the 36-month period is re-set.

The implementation of changes in 2014 in ČSOB increased the balance of non-performing exposures by CZK 116 m, and led to the creation of an additional individual impairment of CZK 58 m.

Outstanding gross amounts and gross amounts of forborne exposures included in the credit portfolio and the related impairment and collateral and financial guarantees as at 31 December 2016 and 2015 are as follows:

(CZKm)	2016				
	Outstanding gross amount	Exposure of collectively and individually assessed assets	Percentage of outstanding gross amount (%)	Individual and collective impairment	Collateral and financial guarantees
Corporate	149,098	2,713	1.8	720	1,210
SME	82,271	1,168	1.4	626	355
Retail	24,183	226	0.9	83	3
Other	28	-	0.5	-	-
<b>Total</b>	<b>255,580</b>	<b>4,107</b>	<b>1.6</b>	<b>1,429</b>	<b>1,568</b>

(CZKm)	2015				
	Outstanding gross amount	Exposure of collectively and individually assessed assets	Percentage of outstanding gross amount (%)	Individual and collective impairment	Collateral and financial guarantees
Corporate	145,051	2,754	1.9	732	1,903
SME	81,073	1,140	1.4	567	403
Retail	20,333	266	1.3	98	5
Other	68	3	4.4	1	-
<b>Total</b>	<b>246,525</b>	<b>4,163</b>	<b>1.7</b>	<b>1,398</b>	<b>2,311</b>

Detail analysis of forborne exposures included in the credit portfolio and the related impairment as at 31 December 2016 and 2015 are as follows:

(CZKm)	2016				
	Exposure of collectively assessed assets	Of which past due but not individually impaired assets	Exposure of individually impaired assets	Individual impairment	Collective impairment
Corporate	734	-	1,979	720	-
SME	141	9	1,027	621	5
Retail	97	14	129	81	2
Other	-	-	-	-	-
<b>Total</b>	<b>972</b>	<b>23</b>	<b>3,135</b>	<b>1,422</b>	<b>7</b>

(CZKm)	2015				
	Exposure of collectively assessed assets	Of which past due but not individually impaired assets	Exposure of individually impaired assets	Individual impairment	Collective impairment
Corporate	728	-	2,026	730	2
SME	81	-	1,059	566	1
Retail	110	9	156	95	3
Other	-	-	3	1	-
<b>Total</b>	<b>919</b>	<b>9</b>	<b>3,244</b>	<b>1,392</b>	<b>6</b>

The following table shows a reconciliation of Gross amounts of forborne exposures for 2016 and 2015 by classes of financial instruments:

(CZKm)	Corporate	SME	Retail	Other	Total
<b>At 1 January 2015</b>	<b>2,884</b>	<b>926</b>	<b>253</b>	<b>-</b>	<b>4,063</b>
Loan which have become forborne	47	478	93	3	621
Loans which are no longer considered to be forborne	(127)	(11)	-	-	(138)
Increase of exposure	24	8	1	-	33
Decrease of exposure	(74)	(261)	(81)	-	(416)
<b>At 31 December 2015</b>	<b>2,754</b>	<b>1,140</b>	<b>266</b>	<b>3</b>	<b>4,163</b>
Loan which have become forborne	1,847	337	58	-	2,242
Loans which are no longer considered to be forborne	(1,846)	(182)	(61)	(3)	(2,092)
Increase of exposure	49	13	-	-	62
Decrease of exposure	(91)	(140)	(37)	-	(268)
<b>At 31 December 2016</b>	<b>2,713</b>	<b>1,168</b>	<b>226</b>	<b>-</b>	<b>4,107</b>

The following table shows a reconciliation of Impairments of forborne exposures for 2016 and 2015 by classes of financial instruments:

(CZKm)	Corporate	SME	Retail	Other	Total
<b>At 1 January 2015</b>	<b>759</b>	<b>409</b>	<b>87</b>	<b>-</b>	<b>1,255</b>
Loan which have become forborne	1	229	45	1	276
Loans which are no longer considered to be forborne	(13)	(9)	-	-	(22)
Increase of exposure	2	82	10	-	94
Decrease of exposure	(17)	(144)	(44)	-	(205)
<b>At 31 December 2015</b>	<b>732</b>	<b>567</b>	<b>98</b>	<b>1</b>	<b>1,398</b>
Loan which have become forborne	28	144	25	-	197
Loans which are no longer considered to be forborne	(89)	(73)	(21)	(1)	(184)
Increase of exposure	63	92	12	-	167
Decrease of exposure	(14)	(104)	(31)	-	(149)
<b>At 31 December 2016</b>	<b>720</b>	<b>626</b>	<b>83</b>	<b>-</b>	<b>1,429</b>

### 38.3 Liquidity risk and funding management

Liquidity risk is the risk that the Bank will not be able to efficiently meet both expected and unexpected current and future cash flows and collateral needs without normal business operations being disrupted. To limit this risk, the Bank pays significant attention to both operational and strategic liquidity management.

#### Operational Liquidity Management

The aim of operational liquidity management is to ensure the smooth processing of the Bank's current payment obligations in CZK as well as in other currencies while minimizing associated cost. Operational liquidity is based on cash flow projections with an outlook of up to ten working days for CZK and one day for other currencies.

#### Funding Management

The actual development of liquidity might vary from ALM's liquidity prediction. The Bank can address an adverse liquidity development in several ways. Most typically, the Bank would adjust its investment policy, i.e. decrease the percentage of liabilities reinvested in a cash form and use the liquidity from maturing bonds for other purposes. In the event of a more sudden decrease of liquidity, the Bank can borrow via repo operations on the market or use regulatory repo facilities (in the CNB or ECB). The capacity and readiness to withstand adverse liquidity development is regularly reviewed by the means of stress tests.

Starting from October 2015 the Bank reports on Liquidity Coverage Ratio (LCR), which compares available liquidity buffers to expected net cash outflows within the 30 day horizon under gravely stressed conditions.

The LCR during the year 2016 and 2015 was as follows:

(%)	2016	2015
31 March	159.9	n/a
30 June	154.9	n/a
30 September	162.3	n/a
31 December	155.1	163.0

The LCR ratio is regularly monitored and reported to the top management of the Bank.

#### Strategic Liquidity Management

The aim of strategic liquidity management is to provide sufficient funding for the Bank's business activities in the medium- and long-term horizon. For the strategic liquidity management, the Bank uses the net-stable-funding-ratio (NSFR) which is defined as a ratio of available stable funding (numerator) to required stable funding (denominator). The strategy of the Bank is to maintain the value of NSFR well above one. That means the Bank aims to maintain matched funding, i.e. to ensure that long-term assets are funded by stable liabilities (contractually or statistically), while short-term liabilities are used for the funding of assets that are short-term and/or liquid.

The NSFR is monitored on a monthly basis and it is regularly reported to the top management of ČSOB.

The NSFR during the year 2016 and 2015 was as follows:

(%)	2016	2015
31 March	140.5	143.1
30 June	138.3	137.0
30 September	141.2	133.0
31 December	142.7	138.9

In addition to internally defined limits, the Bank must also comply with a regulatory limit on the basis of minimum statutory reserves deposited with CNB. The limit presently equals to 2% of customer deposits.

### Analysis of financial liabilities by remaining contractual maturity

The tables below summarise the contractual maturity profile of the Bank's financial liabilities based on the contractual undiscounted repayment obligations.

The following table sets out the financial liabilities of the Bank by remaining contractual maturity as at 31 December 2016:

(CZKm)	On demand	Less than 1 year	1 year to 5 years	More than 5 years	Total
<b>Financial liabilities</b>					
Financial liabilities held for trading					
Financial derivatives	-	3,616	6,487	2,136	12,239
Other than financial derivatives	-	18,589	6,522	2,278	27,389
Financial liabilities designated at fair value through profit or loss	-	57	1,212	308	1,577
Financial liabilities at amortised cost	657,684	227,586	16,110	8,109	909,489
Fair value adjustments of the hedged items in portfolio hedge	4,796	-	-	-	4,796
Derivatives used for hedging	-	2,728	5,401	2,117	10,246
Other liabilities (Note: 26)	-	3,814	-	-	3,814
<b>Total carrying value</b>	<b>662,480</b>	<b>256,390</b>	<b>35,732</b>	<b>14,948</b>	<b>969,550</b>

The following table sets out the financial liabilities of the Bank by remaining contractual maturity as at 31 December 2015:

(CZKm)	On demand	Less than 1 year	1 year to 5 years	More than 5 years	Total
<b>Financial liabilities</b>					
Financial liabilities held for trading					
Financial derivatives	-	4,175	5,944	2,124	12,243
Other than financial derivatives	-	11,753	3,652	2,388	17,793
Financial liabilities at amortised cost	605,062	168,708	15,240	8,931	797,941
Fair value adjustments of the hedged items in portfolio hedge	4,062	-	-	-	4,062
Derivatives used for hedging	-	2,649	5,572	2,407	10,628
Other liabilities (Note: 26)	-	4,421	-	-	4,421
<b>Total carrying value</b>	<b>609,124</b>	<b>191,706</b>	<b>30,408</b>	<b>15,850</b>	<b>847,088</b>

The maturity of contingent liabilities and commitments of 176,983 CZK m (2015: CZK 163,860 m) is less than one year. This represents the undiscounted cash flows of the Bank's contingent liabilities and commitments on the basis of their earliest possible contractual maturity. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

The liquidity risk of the Bank is not managed based on the remaining contractual maturities of the financial instruments, as such the Bank's expected cash flows on these instruments vary significantly from this analysis (Note: 32). For example, undrawn loan commitments are not expected to be drawn down immediately.



### 38.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices. The Bank classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored based on a historic VaR methodology that reflects the interdependency between risk variables. The secondary measure for risk management is Basis Point Value (BPV) sensitivity. Non-trading positions are managed and monitored using BPV sensitivity analysis.

#### Market risk – Trading

The Board of Directors has set limits on the level of risk that may be accepted. The Bank applies a VaR methodology to assess the market risk positions held and to estimate the potential economic loss based upon assumptions for various changes in market conditions. VaR is a method used to measure financial risk by estimating a potential negative change in the market value of a portfolio at a given confidence level and over a specified time horizon. The Bank uses a full linear VaR model for interest rate and foreign exchange rate risk. These calculations are based on historic scenarios derived from a two-year history. The Bank has no net position in FX options, nor any position in equity. A nominal technical limit for reminder products, in particular interest rate options, commodity derivatives and structured bonds. Positions in these products are not allowed to be material as back-to-back approach is required.

Standard VaR calculations are supplemented by a sophisticated system of stress tests. They consist of examples of extreme, but plausible events on the financial markets to test their impact on the market value of positions currently held by the Bank. The Bank analyses scenarios, dependent and independent of the Bank's position. Also, real historical scenarios are evaluated on a regular basis.

To enhance the system of risk management, the Bank also uses other methods of risk monitoring, such as interest rate sensitivity BPV, and stop-loss limits.

#### *Objectives and limitations of the VaR methodology*

The Bank uses the historical VaR methodology to measure and monitor interest rate and foreign exchange rate risks in the trading book observing the relevant Basel II standards. The accuracy of estimated results is verified through back-testing.

#### *VaR assumptions*

When measuring risks, the Bank applies VaR assumptions to estimate potential losses at a 99% confidence level that is not expected to be exceeded if the current market risk positions were to be held unchanged for 10 days. The use of a 99% confidence level means that, within a ten-day horizon, losses exceeding the VaR figure should occur, on average, not more than once every 100 days. The Bank uses historical daily changes in market variables to assess possible changes in the market value of the trading portfolio based on historical data from the past 500 days.

Since VaR is an integral part of the Bank's market risk management, VaR limits have been established for all trading operations and exposures are reviewed daily against the limits by the management.

The VaR model is back tested on a daily basis. Daily VaR (1 day holding period) is compared with theoretic profit or loss from holding previous day position. Daily VaR is also compared with the actual profit or loss made by the trading book.

The Bank holds regulatory approval to use an internal VaR model for the calculation of capital requirements for interest rate and foreign exchange risks.

ČSOB calculate a Stress VaR to fulfil CRR / CRD IV requirements for market risk capital. A one year historic stress period is used for determining of stress scenarios. These in combination with antithetic scenarios for the same periods are used for computation of stress VaR. All other assumptions are identical to the standard VaR measurement.

The tables below show potential gains or (losses) analysed using VaR 10D 99% model in 2016 and 2015:

(CZKm)	Interest rate	Foreign exchange	Effect of correlation	Global VaR total
31 December 2016	148	5	(4)	149
Average during the period	168	16	(15)	169
Highest	227	52	(53)	226
Lowest	119	2	1	122

(CZKm)	Interest rate	Foreign exchange	Effect of correlation	Global VaR total
31 December 2015	151	20	(16)	155
Average during the period	127	12	(10)	129
Highest	178	54	(55)	177
Lowest	98	3	(3)	98

### Market risk – Investment portfolio

#### *Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board of Directors has established limits on the BPV sensitivity. The Board of Directors has set secondary limits on interest rate gaps for stipulated periods. Positions are monitored on a weekly basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following tables demonstrate the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Bank's statement of income and equity.

The sensitivity of the statement of income is calculated by revaluing financial assets designated at fair value through profit or loss for the effects of the assumed changes in interest rates. The sensitivity of the statement of income is analysed by the maturity of the asset. The total sensitivity of the statement of income is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The sensitivity of equity is calculated by revaluing Available-for-sale financial assets, including the effect of any associated hedges, and swaps designated as cash-flow hedges, for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by the maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The Bank's investment portfolio consists of predominantly linear interest rate sensitive products.

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) as at 31 December 2016 due to revaluation of assets and liabilities that are measured at fair value on recurring basis:

(CZKm)	Change in basis points	Sensitivity of the statement of income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	(12.1)	7.1	(66.2)	(39.6)	(110.8)
EUR	+ 10	0.7	0.5	(1.8)	(3.7)	(4.3)
USD	+ 10	-	-	(2.1)	-	(2.1)
CZK	- 10	12.1	(7.1)	66.2	39.6	110.8
EUR	- 10	(0.7)	(0.5)	1.8	3.7	4.3
USD	- 10	-	-	2.1	-	2.1

(CZKm)	Change in basis points	Sensitivity of other comprehensive income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	1.4	(11.4)	(145.3)	(88.5)	(243.8)
EUR	+ 10	-	0.3	31.9	(82.0)	(49.8)
USD	+ 10	-	(0.2)	(4.4)	(39.5)	(44.1)
CZK	- 10	(1.4)	11.4	145.3	88.5	243.8
EUR	- 10	-	(0.3)	(31.9)	82.0	49.8
USD	- 10	-	0.2	4.4	39.5	44.1

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) as at 31 December 2015 due to revaluation of assets and liabilities that are measured at fair value on recurring basis:

(CZKm)	Change in basis points	Sensitivity of the statement of income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	(15.1)	1.7	(105.1)	(110.3)	(228.8)
EUR	+ 10	1.3	0.2	(21.9)	38.8	18.4
USD	+ 10	(1.1)	0.1	0.1	33.0	32.1
CZK	- 10	15.1	(1.7)	105.1	110.3	228.8
EUR	- 10	(1.3)	(0.2)	21.9	(38.8)	(18.4)
USD	- 10	1.1	(0.1)	(0.1)	(33.0)	(32.1)

(CZKm)	Change in basis points	Sensitivity of other comprehensive income				Total
		Less than 6 months	6 months to 1 year	1 year to 5 years	More than 5 years	
CZK	+ 10	5.3	(2.4)	(59.3)	(25.4)	(81.8)
EUR	+ 10	(0.1)	0.3	51.7	25.2	77.1
USD	+ 10	(0.1)	(0.4)	(7.5)	(43.8)	(51.8)
CZK	- 10	(5.3)	2.4	59.3	25.4	81.8
EUR	- 10	0.1	(0.3)	(51.7)	(25.2)	(77.1)
USD	- 10	0.1	0.4	7.5	43.8	51.8

### Currency risk

Currency risk is the risk that the value of a financial instrument would fluctuate due to changes in foreign exchange rates. The Bank adopted a strategy under which the banking book has no open positions in foreign currencies. Positions are monitored on a daily basis and hedging strategies are used to close such positions. Minimum technical residual open positions in foreign currencies are allowed; the Bank sets limits for these positions. The technical currency position is added to the currency position of the trading book position and reported in aggregate.

The table below shows the foreign currency risk sensitivity of the statement of income (before tax) as at 31 December 2016 and 2015:

	2016			2015		
	Net position in foreign currency (CZKm)	Increase of foreign exchange rate by 1 CZK/EUR	Decrease of foreign exchange rate by 1 CZK/EUR	Net position in foreign currency	Increase of foreign exchange rate by 1 CZK/EUR	Decrease of foreign exchange rate by 1 CZK/EUR
EUR	8	-	-	(10)	-	-

Sensitivity of the statement of income to currencies other than EUR is not significant.

### Equity price risk

Equity price risk is the risk that the fair values of equities will decrease as a result of changes in the levels of equity indices and in the value of individual stocks. Investment equity price risk exposure arises from the Bank's investment portfolio.

- If, at the end of the accounting period, a share is quoted at less than 70% of its acquisition value or;
- If, during a period of one year before the end of the accounting period, the share price of a share was permanently lower than its acquisition value;

The share is irrevocably impaired to the closing quotation at end of the accounting period.

The effect on equity (as a result of a change in the fair value of equity instruments included in Available-for-sale financial assets at 31 December 2016) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, is as follows:

(CZKm)	Change in equity price (%)	Effect on equity
VISA Inc. quotation	- 10	(29)
	+ 10	29

The effect on equity (as a result of a change in the fair value of equity instruments included in Available-for-sale financial assets at 31 December 2015) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, was as follows:

(CZKm)	Change in equity price (%)	Effect on equity
VISA Inc. quotation	- 10	(35)
	+ 10	35

### Prepayment risk

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

Prepayment risk of the Bank's products is negligible, however, it is regularly monitored and assessed.

## 38.5 Operational risk

The Bank defines operational risk in line with Basel III as the risk of loss resulting from inadequate or failed internal procedures, people and systems, or from external events. Operational risks include legal, compliance and tax risks. The impact of incidents on the Bank's reputation is taken into consideration when assessing the Bank's vulnerability in respect of operational risk incidents.

### Principles of Operational Risk Management

Operational risk management starts with the identification of operational risks having materialized within the ČSOB, as well as an assessment of the Bank's vulnerability in respect of potential risks that have not materialised yet. Operational risk management focuses primarily on the key risks and the most risky areas for potential losses. The assessment involves ranking the risks and risk events in terms of their severity and anticipated frequency. The assessment is followed by the decision of an accountable manager, i.e. acceptance of risk or its mitigation by implementing appropriate control measures and/or risk transferring to the 3<sup>rd</sup> parties and/or risk insurance. Risk events that cannot be prevented may be also mitigated by business continuity arrangements.

### Operational Risk Management Governance

The basic objective is to make operational risk management a natural part of the decision making in business units. Operational risk management governance is promoted by the CRO and the Risk Function. Regular meetings focusing on operational risk management take place at ČSOB subsidiaries and at distribution entities and departments responsible for creating new products within the ČSOB Group.

#### *Non-financial Risk Management Department (NFRD)*

The NFRD is responsible for reporting in the non-financial risk management area, including operational risk management. This includes coordination, implementation of methodology, assurance of independent control, advisory to business units and training. NFRD covers also business continuity and information security areas. Other risks related to operational risk are coordinated by special units, including the Compliance Unit, Communication Unit, Legal Unit and Tax Unit.

#### *Local Operational Risk Managers (the "LORMs")*

LORMs are first line support for business managers in respect of operational risks. LORMs also act as business continuity coordinators, compliance coordinators and information risk coordinators. Beside frequent contacts, regular meetings of LORMs are organised by the NFRD every quarter for training and exchange of information.

#### *Crisis Management*

Apart from the regular operational risk management infrastructure, the Bank has also established a crisis management infrastructure. Major incidents within the Bank are resolved by the Crisis Management Committee with the involvement of the Board of Directors members. Additionally, the Bank has in place a procedure for resolving local incidents. This procedure is used for more explicit and structured situations, i.e. not complex crises.

### Building Blocks of Operational Risk Management

#### *Loss Data Collection*

Loss events are registered into a loss database, which contains a full description of cases involving a higher level of loss. The quality of loss data is monitored on a daily basis, and data is reconciled regularly.

#### *Detailed Risk Scan*

The Detailed Risk Scan aims to identify and quantify operational risks in products, activities, processes and systems. This activity is forward-looking and allows future developments, e.g. an improvement in the control framework, to be taken into account. It consists of workshops organised and facilitated by the LORM, where business representatives and control function representatives discuss operational risks faced in order to reach a consensus on the adequate risk response (risk acceptance or mitigation).

### *Risk Scan*

Every year, before the risk appetite statement is defined, the Bank executes a risk scan identifying and assessing its top risks. All material risk types are explicitly considered, but it is not necessary that a top risk is ultimately withheld for every risk type. The Risk Scan is executed and reported based on the KBC Group Risk Scan Guidance.

The prime responsibility for the identification and assessment of the top risks lies with the business. Input for the risk scan can be derived from several sources, including the main risks identified in the Internal Control Statement, audit recommendations, existing claims, economic forecasts and so on. The Risk Function facilitates the process. This may include gathering business input and documenting the conclusions of the risk scan. The business may call upon the Risk Function for assistance with the identification and assessment of the top risks as well. In any case, the Risk Function challenges the assessment details.

The results of the risk scan, as well as the risk response thereto (acceptance, non-acceptance, mitigating actions), can lead to changes to the existing business plans. Furthermore, they are used as input for the definition of risk appetite in the strategic planning process.

### *Group Key Controls and Zero Tolerances (GKC/ZT)*

The Group Key Controls and Zero Tolerances are top down basic control objectives used to mitigate key & killer non-financial risks (including risks to reputation) that are inherent to the processes of the business entities. Each GKC contain the key & killer operational risks related to the involved business process.

### *Key Risk Indicators*

Key risk indicators are measurable metrics or indicators used to track the exposure to loss or other difficulties. Key risk indicators are used for informing the management of the current level of risk exposure and/or the effectiveness of the controls in place.

## **39. CAPITAL**

### **Capital Adequacy**

Capital adequacy measures the financial strength and stability of an institution. It compares the amount of the capital held by a financial institution to the risk of possible decline in value of assets on its statement of financial position.

Capital adequacy (or solvency) risk is the risk that the capital base of the bank might fall below an acceptable level. In practice, this entails checking solvency against the minimum regulatory and in-house solvency ratios and its active steering.

### **Capital targets and structure**

Regarding the capital targets and structure, the Bank fully follows the KBC Group Capital Policy stating that fully owned subsidiaries shall: (i) hold the regulatory minimum capital (all capital in excess of the regulatory minimum must be held at the Group level), and (ii) build up the regulatory capital from equity.

For the purpose of the ICAAP process, available capital of the Pillar II in the Bank coincides with the Common equity Tier 1 capital under Pillar I.

### **Managing solvency**

ČSOB reports its solvency calculated on the basis of IFRS balances taking into account all relevant regulatory requirements. Solvency targets based on external regulatory capital requirements were met throughout 2016 and 2015 with adequate buffers above the regulatory minimum standards, underpinning the very strong capital position of the Bank.

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

In accordance with Basel III, Pillar 2 requirements, the Bank has an Internal Capital Adequacy Assessment Process (ICAAP) in place. The ICAAP examines both the current and future capital situation. To assess the latter situation, a four-year forecast is drawn up for required and available capital, both regulatory and economic, according to a basic scenario that takes account of anticipated internal and external growth, and according to various likely alternative scenarios. The Bank uses also other instruments as required by Pillar 2 mainly in the area of capital planning, stress testing and risk strategies.

The Basel III agreement and corresponding European CRD IV Directive and Regulation introduced new, more stringent capital requirements for financial institutions. According to these requirements, the legal minimum tier-1 ratio increased to 6.0% (with a common equity ratio of 4.5%). On top of this, a capital conservation buffer, and an extra charge for systemic risks of banks were applied. In addition, a countercyclical buffer (0.5% of Common Equity Tier 1, to be determined by the national regulatory authority) will be introduced in 2017. The Bank incorporated major changes / ratios into the regular management of the risk and capital positions.

The Bank manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital instruments.

Taking into account the planned increase of required capital in 2017, the Bank asked for the first time the ČNB for a permission to retain a part of the net profit as reported in its regulatory financial statements for the year 2016 to the official 2016 prudential results before the audit procedure and annual meeting decision on dividend pay-out. As a consequence of the approval, the ČSOB Tier 1 capital increased by CZK 5,397 m as at 31 December 2016. This corresponds to the retention of approximately one third of the 2016 profit of CSOB bank.

The following table shows the capital and CAD ratio calculated under Basel III in 2016 and 2015 for ČSOB:

(CZKm)	2016	2015
Tier 1 capital	63,583	59,665
Tier 2 capital	533	500
<b>Total capital</b>	<b>64,116</b>	<b>60,165</b>
Regulatory capital requirements	27,318	26,043
<b>Risk weighted assets</b>	<b>341,476</b>	<b>325,540</b>
Capital adequacy ratio	18.78%	18.48%



## RELATED PARTIES REPORT

### Report of the Board of Directors of Československá obchodní banka, a. s., on Relations between Related Parties

#### 1. Controlled Entity

Československá obchodní banka, a. s. registered office Praha 5, Radlická 333/150, postcode 150 57, Company ID No. 000 01 350, incorporated in the Commercial Register, Section B XXXVI, File 46, maintained at the Municipal Court in Prague (hereinafter "ČSOB" or the "Bank").

#### 2. Controlling Entity

KBC Bank NV registered office Havenlaan 2, B-1080 Brussels, Belgium is the sole shareholder of ČSOB.

All shares of KBC Bank NV are held (directly or indirectly) by the KBC Group NV (legal entity).

#### 3. Structure of the relationships between the Controlling Entity and the Controlled Entity as well as between the Controlled Entity and Entities Controlled by the same Controlling Entity

KBC Bank NV, a member of the KBC Group financial bank-insurance group, is regulated by the National Bank of Belgium. KBC Group focuses on its home markets of Belgium, the Czech Republic, Slovakia, Bulgaria, Hungary and Ireland and, to a limited extent, several other countries.

The KBC Group NV (legal entity) shares are publicly traded on the Euronext Exchange in Brussels. No shareholder has a shareholding of more than 20%.

Attachment 1 of this report gives an overview of the ČSOB and KBC group companies, which is also available at [www.kbc.com](http://www.kbc.com).

**In the monitored period the Bank had relations mainly with the following related entities:**

Company	Business Address	
Bankovní informační technologie, s.r.o.	Radlická 333/150, 150 57 Praha 5	Czech Republic
CBCB - Czech Banking Credit Bureau, a.s.	Na Vítězné pláni 1719/4, 140 00 Praha 4	Czech Republic
Centrum Radlická a.s.	Radlická 333/150, 150 57 Praha 5	Czech Republic
Českomoravská stavební spořitelna, a.s.	Vinohradská 3218/169, 100 17 Praha 10	Czech Republic
Československá obchodná banka, a. s.	Michalská 18, 815 63 Bratislava	Slovak Republic
ČSOB Advisory, a.s.	Radlická 333/150, 150 57 Praha 5	Czech Republic
ČSOB Asset Management, a.s., investment company	Radlická 333/150, 150 57 Praha 5	Czech Republic
ČSOB Factoring, a.s.	Benešovská 2538/40, 101 00 Praha 10 - Vinohrady	Czech Republic
ČSOB Leasing, a.s.	Na Pankráci 310/60, 140 00 Praha 4	Czech Republic
ČSOB Leasing, a.s.	Panónska cesta 11, 852 01 Bratislava	Slovak Republic
ČSOB Penzijní společnost, a. s., a member of the ČSOB group	Radlická 333/150, 150 57 Praha 5	Czech Republic
ČSOB Poist'ovňa a.s.	Vajnorská 100/B, 831 04 Bratislava	Slovak Republic
ČSOB Pojišťovna, a. s., a member of the ČSOB holding	Masarykovo náměstí 1458, 532 18 Pardubice - Zelené předměstí	Czech Republic
ČSOB Property fund, a.s.	Radlická 333/150, 150 57 Praha 5	Czech Republic
ČSOB stavebná sporiteľ'ňa, a.s.	Radlinského 10, 813 23 Bratislava	Slovak Republic
Eurincasso, s.r.o.	Benešovská 2538/40, 101 00 Praha 10 - Vinohrady	Czech Republic
Hypoteční banka, a.s.	Radlická 333/150, 150 57 Praha 5	Czech Republic
KBC Asset Management NV	Havenlaan 2, 1080 Brussels (Sint-Jans Molenbeek)	Belgium
KBC Bank NV	Havenlaan 2, 1080 Brussels (Sint-Jans Molenbeek)	Belgium
KBC Group NV (legal entity)	Havenlaan 2, 1080 Brussels (Sint-Jans Molenbeek)	Belgium
KBC Group NV Czech Branch, organizational unit	Radlická 333/150, 150 57 Praha 5	Czech Republic
KBC Investments Limited	Old Broad Street 111, London	Great Britain
K & H BANK Zrt.	Lechner Ödön fasor 9, 1095 Budapest	Hungary
Merrion Properties, s.r.o.	Radlická 333/150, 150 57 Praha 5	Czech Republic
Patria Finance, a.s.	Jungmannova 745/24, 110 00 Praha 1	Czech Republic
Patria Corporate Finance, a.s.	Jungmannova 745/24, 110 00 Praha 1	Czech Republic
Patria investiční společnost, a.s.	Jungmannova 745/24, 110 00 Praha 1	Czech Republic
Patria Online, a.s.	Jungmannova 745/24, 110 00 Praha 1	Czech Republic
První certifikační autorita, a.s.	Podvinný mlýn 2178/6, 190 00 Praha 9	Czech Republic
Radlice Rozvojová, a.s.	Radlická 333/150, 150 57 Praha 5	Czech Republic
SousedceZ s.r.o.	Radlická 333/150, 150 57 Praha 5	Czech Republic

## 4. Purpose of Controlling Entity Measures and Means of Control

The KBC Group NV (legal entity), KBC Bank NV respectively, controls ČSOB through decisions made by a sole shareholder to the extent of the competence of the General Meeting according to the Act on Commercial Companies and Cooperatives.

The controlling entity also exercises its influence through its representatives on the governing bodies of ČSOB - i.e. the Supervisory Board and the Board of Directors. First and foremost, this involves cooperation and coordination of activities related the consolidated risk management, auditing, and compliance with the prudential rules that apply to banks and other financial institutions, and the legal requirements.

## 5. Review of Activities in the Accounting Period, Induced by the Interest of the Controlling Entity or its Controlled Entities

Unless stated otherwise, no activities were carried out in the accounting period induced by the controlling entity or its controlled entities that would affect more than 10% of the assets of ČSOB equity, including common business transactions.

During the accounting period, ČSOB repeatedly accepted liabilities towards KBC Bank NV, including short-term money market trading deposits and promissory notes, the value of which exceeded 10% of the company's equity. These transactions aim at improvement of the efficiency of the use of the financial assets within the group. These outstanding obligations arose during the ordinary course of business and are subject to comparable terms (including interest rates and security), as transactions with third party counterparties. The Bank incurred no damage from the fulfilment of these contracts.

On 26 June 2012, ČSOB executed a revolving loan agreement with ČSOB Leasing. The credit limit was increased to CZK 12.5 bn by the amendment No. 5 concluded on 24 June 2016 and further decreased to CZK 6 bn by amendment No. 7 concluded on 10 October 2016. During the accounting period the credit limit exceeded 10% of the Bank's equity. This is a standard bank product which is ordinarily provided even to unrelated parties under comparable conditions. The Bank incurred no damage from the fulfilment of these contracts.

## 6. Review of Mutual Agreements between Controlled Entity and Controlling Entity or among Controlled Entities

During the accounting period, ČSOB had various relations with the controlling entity as well as other companies controlled by the controlling entity (hereafter "related entities" for the Related Parties Report) based on common business activities.

The contractual relations were in the following areas:

### BANKING SERVICES

#### Accounts, Deposit Products, Domestic and International Payments Services, Domestic and International Cash Management

During the accounting period, ČSOB concluded contracts or had concluded contracts in the previous accounting periods to provide services for maintaining various types of accounts, current and term accounts, interbank deposits, (including amendments on early termination (default) of some deposits, along with settling interest and compensation payments), accounts

for deposit of funds intended to acquire or increase participation in a company, and to provide the following products and domestic and international payments services such as - Cash Management NightLine, Virtual Cash Pooling and Real One-Way Cash Pooling. The contracts were concluded under standard business terms and conditions.

### Payment Cards

During the accounting period, ČSOB concluded contracts or had concluded contracts in the previous accounting periods to issue, accept and process payment card transactions. The contracts were concluded under standard business terms and conditions.

### Electronic Banking

During the accounting period, ČSOB concluded contracts or had concluded contracts in the previous accounting periods through which it provided the following electronic banking products: ČSOB Linka 24, ČSOB Internetbanking, ČSOB Businessbanking, ČSOB MultiCash 24 and ČSOB Edifact 24. The contracts were concluded under standard business terms and conditions.

### Cheques and Bills of Exchange

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for procuring bills of exchange and their custody, and contracts for securing the bill-of-exchange programme. The contracts were concluded under standard business terms and conditions.

### Credit Products and Guarantees

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods through which it provided the following credit products: overdrafts, commercial loans, revolving loans, special purpose loans, subordinated loans, interbank loans, (including amendments on the early termination (default) of some loan agreements, along with interests settlements and compensation payment) and current account overdrafts, and accepted and issued guarantees, confirmed or open letters of credit, and/or bought back claims from letters of credit, and provided guarantees. The related entities paid contractual fees, remuneration and interest for these services. The contracts were concluded under standard business terms and conditions.

### Investment Services

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for purchasing and selling investment instruments, ISDA contracts, custody contracts, contracts for settling investment instrument transactions, contracts for administering securities, depository contracts, agreements on the contact bank, and agreements on the authorization of fax instructions for settling and administering securities. The remuneration provided by the related entities consisted of commissions and contractual fees. The contracts and agreements were concluded under standard business terms and conditions.

### Mortgage Bonds and Bonds

During the accounting period, ČSOB concluded mandate contracts or had concluded mandate contracts in previous accounting periods for procuring an issue of mortgage bonds issued on the domestic market as part of a bond programme, and mandate contracts for procuring an issue of debentures, contracts for the subscription and purchase of mortgage bond/bonds, and contracts for administering the issue and arranging payments. The related entities paid contractual commissions for these services. The contracts were concluded under standard business terms and conditions.

### Receivables

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for receivables administering and factoring. The Bank provided contractual commissions to related entities for these services. The contracts were concluded under standard business terms and conditions.

## OTHER RELATIONS

### Insurance Contracts

During the accounting period, ČSOB concluded insurance contracts or had concluded insurance contracts in previous accounting periods. The consideration consisted of insurance and insurance compensation. The contracts were concluded under standard business terms and conditions.

### Lease and Rent Contracts

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for the renting/leasing non-residential areas, parking places and movable assets. The consideration consisted of the contractual prices or the lease of certain items. The contracts were concluded under standard business terms and conditions.

### Cooperation Agreements – Employee Benefits

During the accounting period, ČSOB concluded cooperation agreements – employee benefits – or had concluded contracts in previous accounting periods. The consideration consisted of providing employee benefits. The agreements were concluded under standard business terms and conditions.

### Cooperation Agreements – Selling Products and Services

During the accounting period, ČSOB concluded cooperation agreements, framework, mandate and commission agent's contracts or had concluded these contracts and agreements in previous accounting periods particularly about cooperating in product sales, product sales agency, sales support and the use of technology for this purpose, consultancy, and opportunity-seeking. The consideration consisted of cooperation, contractual commissions, contractual fees or the sale of products. The contracts were concluded under standard business terms and conditions.

### Cooperation Agreements – Observance of Tax Obligations (VAT Grouping)

On 9 December 2016, ČSOB concluded agreements with some of the entities controlled by the same controlling entity (Centrum Radlická, ČMSS, ČSOB Advisory, ČSOB AM, ČSOB Penzijní společnost, ČSOB Pojišťovna, Hypoteční banka, Patria Finance, Patria investiční společnost, Patria Online) on cooperation on the common fulfilment of tax obligations (VAT) that were also valid and effective during the accounting period. The consideration consisted of the common fulfilment of tax obligations. The agreements were concluded under standard business terms and conditions.

### Agreements on ICT Services

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods on providing ICT services. The consideration consisted of contractual commissions. The contracts and agreements were concluded under standard business terms and conditions.

### Agreements on Providing Services – Call Centre

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide call centre services. The consideration consisted of contractual commissions. The contracts and agreements were concluded under standard business terms and conditions.

### Agreements on Providing Services – Back Office and Other Related Services

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide back-office services and supporting processes, i.e. risk management cooperation, developing models, management consultancy, central procurement, accounting and tax services and processing foreign payments. The consideration consisted of contractual commissions and consultations. The contracts and agreements were concluded under standard business terms and conditions.

### Agreements on Providing Services – Facilities Management

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide facilities management services i.e. accounting and assets administration, food vouchers and catering, accommodation, postal services, document archiving, telephone exchange, fleet management and parking administration and transferring or purchasing movable property. The consideration consisted of contractual commissions. The contracts and agreements were concluded under standard business terms and conditions.

### Agreements on Providing Services – Processing Financial Reporting

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide processing financial reports for external users services especially for the Czech National Bank. The consideration consisted of contractual commissions. The contracts and agreements were concluded under standard business terms and conditions.

### Agreements on Providing Services – Other Supporting Services

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods on cooperation and providing internal audit and compliance services, finance and accounting administrative support, human resources management including labour law relations and using employees and administrative support. The consideration consisted of services and contractual commissions. ČSOB also concluded agreements on personal data processing and transmitting information, maintaining confidentiality agreements, etc. The contracts and agreements were concluded under standard business terms and conditions.

## Other

### Agreement on the transfer of ICT activities between Bank and ČSOB Leasing

Based on the agreement about transfer of ICT services were formerly outsourced employees of the Bank transferred to ČSOB Leasing starting 1 April 2016. The consideration was in the form of payment for services or licences and provision of hardware and software. The agreement was concluded under standard business terms and conditions.

## PROFIT SHARES AND OTHER MEASURES

On 22 April 2016, KBC Bank NV, as the sole shareholder to the extent of the competence of the General Meeting, decided on the distribution of the 2015 profit so that the profit of CZK 4.781 bn was paid to the sole shareholder.

During the accounting period, ČSOB received revenue as shares of the profit from BANIT, ČMSS, ČSOB Factoring, Hypoteční banka, ČSOB Advisory, ČSOB Leasing, ČSOB Penzijní společnost, ČSOB Pojišťovna, ČSOB AM, Patria Online, První certifikační autorita and CBCB.

During the accounting period, ČSOB also adopted resolutions of the sole shareholder/partner on behalf of subsidiaries where the Bank is the sole shareholder/partner. These were the approval of the year-end financial statements, settling the profit and paying dividends, electing Board members and their remuneration, changing the Articles of Association, approval of the status of some subsidiaries, and an increase/decrease in share capital and/or share premium.

## 7. Assessment of Incurred Damage to Controlled Entities

No damage was incurred from the contractual and other relationships between ČSOB and the controlling entity.

## 8. Evaluation of the relationship between the Controlling Entity and the Controlled Entity as well as between the Controlled Entity and Entities controlled by the same Controlling Entity

The common synergy within the ČSOB group and the KBC group brings positive effects in effective cost management, human resources, and support for process configuration to ensure compliance with the company strategy. The cooperation also helps to reduce the risk of some transactions such as the risks of providing sensitive information to third parties.

The Bank provides banking services for its subsidiaries, associates and joint ventures, such as loans, overdrafts, interest-bearing deposits and current accounts, as well as other services.

The outstanding balances of the assets and liabilities with KBC Bank NV and the entities under common control principally comprise the fair value of derivative financial instruments, debt instruments, repo transactions and promissory notes.

The mutual cooperation between companies in the KBC group and the ČSOB group, as well as other companies controlled by ČSOB, helps to build a common market position and allows the range of financial services offered to their clients to be extended such as the product portfolio, including mortgages and building savings loans, asset management, collective investment, pension fund products, leasing, factoring and insurance products and also services for trading equities on financial markets.

## 9. Accounting Period

This report describes the relations for the accounting period from 1 January 2016 to 31 December 2016.



## 10. Conclusion

The Board of Directors of ČSOB states that this Report was prepared within the stated period and according to Section 82 of the Act on Commercial Companies and Cooperatives. When processing the report the Board of Directors exercised due professional care and the contents of the Report reflect the purpose of the legal provisions of the Act on Commercial Companies and Cooperatives with regard to the ownership structure of ČSOB.

In Prague, 22 March 2017

Československá obchodní banka, a. s.

On behalf of the Board of Directors



**John Arthur Hollows**

Chairman of the Board of Directors



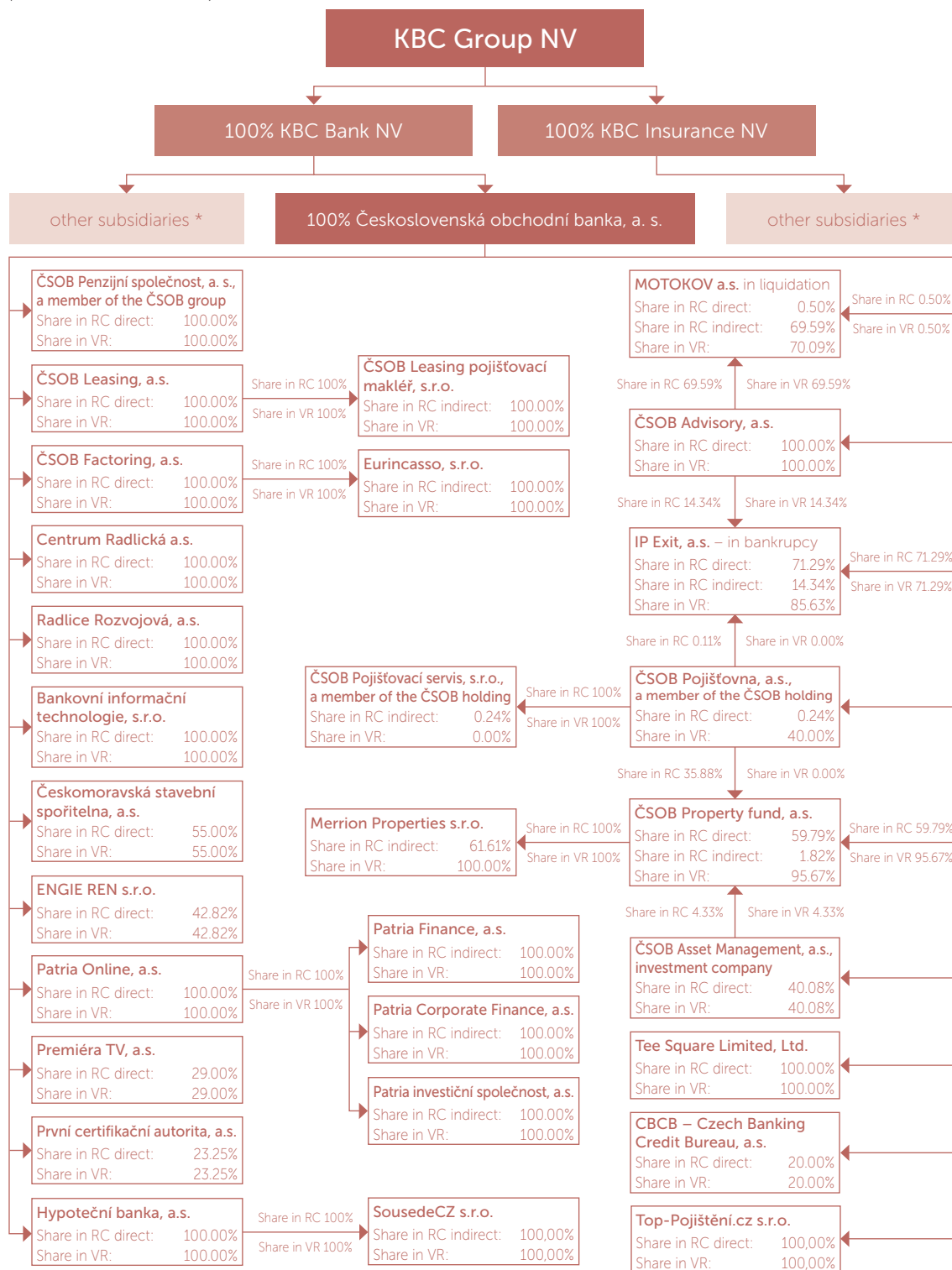
**Jiří Vévoda**

Member of the Board of Directors

## Appendix to the Related Parties Report

### Overview of Companies of the KBC Group and the ČSOB Group

(as at 31 December 2016)



#### Explanatory notes:

Percentage shares shown for individual companies are expressed from the ČSOB point of view as a parent company. All shares of KBC Bank and KBC Insurance are held (directly or indirectly) by the KBC Group.

ČSOB is 100% owned and fully controlled by KBC Bank.

\* For complete overview of "other subsidiaries" of the KBC Group please refer to KBC's corporate website [www.kbc.com](http://www.kbc.com), where detail information are available.

RC: registered capital

VR: voting rights

## ADDITIONAL INFORMATION

### ČSOB Securities

#### Shares

#### Shares and Share Capital of ČSOB

	as at 31 December 2016
ISIN	CZ0008000288
Class	Ordinary shares
Type	Bearer shares
Edition	Book-entered
Number of shares	292,750,002
Nominal value	CZK 20
Total issue volume	CZK 5,855,000,040
<b>Amount of share capital</b>	<b>CZK 5,855,000,040</b>
Paid up in full	100%

KBC Bank NV, with its registered address at: Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek), Belgium, is the sole shareholder of ČSOB.

**ČSOB shares are not publicly tradable on any official regulated market in either an EU member state, or an EEC member state.**

ČSOB has not issued any convertible bonds or priority bonds as defined by Section 286 of the Act No. 90/2012 Coll., on Commercial Companies and Cooperatives. In 2016, ČSOB neither held any own shares, nor issued stock certificates.

#### Rights Attached to ČSOB Shares

Rights and obligations of a shareholder are stipulated by legal regulations, in particular by the Act on Commercial Companies and Cooperatives and the Articles of Association of ČSOB.

#### Shareholder rights attached to ČSOB shares include in particular:

- a) The right to obtain a share in the company's profit (dividend) approved by the General Meeting for distribution according to the company's economic results.
- b) The right to ask the Board of Directors to convene a Meeting in accordance with legal regulations.
- c) The right to attend the General Meeting of Shareholders. At a General Meeting, shareholders have the right to
  1. vote;
  2. request and receive explanation to matters related to the company and controlled persons, should such explanation be necessary to assess a topic discussed by the General Meeting; and
  3. put forward proposals and counter-proposals.
- d) The right to obtain a share in the liquidation balance when the company is dissolved through liquidation.

Voting rights attached to ČSOB shares are unlimited. One share confers one vote.

## Bonds and Investment Certificates

(outstanding)

**In the Czech Republic, ČSOB is an issuer of bonds issued under the ČSOB's bond issuance program.** The program was approved by the Securities Commission in November 2003 (including joint issue terms and conditions for a previously non-determined number of bond issues) with a maximum amount of CZK 30 bn of outstanding bonds and 10-year tenure. This bond issuance program was closed. Any issue of bonds or any bond programe are not currently prepared.

**By 31 December 2016,** ČSOB recorded the following bond issues in the Czech Republic:

Issue Name	ISIN	Issue Date	Volume of Bonds Issued (Nominal Value)	
Bond ČSOB likvidní IV/2017	CZ0003703050	2. 2. 2012	CZKm	2,360.16
Bond ČSOB 3M PRIBOR II/2017	CZ0003703183	29. 3. 2012	CZKm	210
Bond ČSOB likvidní VI/2017	CZ0003703472	6. 8. 2012	CZKm	4,000

None of ČSOB bonds is listed (publicly tradable on any official regulated market in either an EU member state, or an EEC member state).

**Since 2012, ČSOB is an issuer of investment certificates issued under the certificate issuance program (public or non public) in the Czech Republic.**

**By 31 December 2016,** ČSOB recorded the following investment certificate issues in the Czech Republic:

Issue Name	ISIN	Issue Date	Volume of Investment Certificates Issued (Nominal Value)	
ČSOB Investiční certifikát IX. (Oil & Gas)	CZ0000300306	19. 2. 2014	CZKm	135.61
ČSOB Investiční certifikát XX. (Deluxe II)	CZ0000300413	24. 9. 2014	CZKm	160.62
ČSOB Investiční certifikát XXIX. (Eurostoxx50)	CZ0000300587	15. 4. 2015	USDm	5.89
ČSOB Investiční certifikát XXX. (Utility)	CZ0000300579	15. 4. 2015	CZKm	169.35
ČSOB Investiční certifikát XXXI. (Diskont SX5E)	CZ0000300595	22. 4. 2015	CZKm	40.23
ČSOB Investiční certifikát XXXII. (Aero)	CZ0000300603	22. 4. 2015	CZKm	68.77
ČSOB Investiční certifikát XXXIV. (Defensive SX5E)	CZ0000300611	6. 5. 2015	CZKm	208.92
ČSOB Investiční certifikát XXXV. (2nd worst - Index)	CZ0000300645	20. 5. 2015	CZKm	90.05
ČSOB Investiční certifikát XXXVI. (Defensive SX5E)	CZ0000300660	3. 6. 2015	CZKm	136.37
ČSOB Investiční certifikát Unit link I.	CZ0000300652	12. 6. 2015	CZKm	157.00
ČSOB Investiční certifikát Unit link II.	CZ0000300686	10. 7. 2015	CZKm	417.00
ČSOB IC XXXVIII. (4th worst - Healthcare)	CZ0000300694	15. 7. 2015	CZKm	134.12
ČSOB IC XXXIX. (Defensive SX5E)	CZ0000300702	22. 7. 2015	CZKm	142.41
ČSOB Investiční certifikát Unit link III.	CZ0000300710	10. 8. 2015	CZKm	230.82
ČSOB Investiční certifikát Unit link IV.	CZ0000300728	10. 9. 2015	CZKm	261.82
ČSOB Investiční certifikát XL. (Eurostoxx50)	CZ0000300736	14. 10. 2015	CZKm	181.56
ČSOB Investiční certifikát XLI. (German leaders)	CZ0000300751	21. 10. 2015	CZKm	152.26
ČSOB Investiční certifikát Unit link V.	CZ0000300769	10. 11. 2015	CZKm	493.00

Issue Name	ISIN	Issue Date	Volume of Investment Certificates Issued (Nominal Value)	
ČSOB Investiční certifikát XLII. (Banks Defensive)	CZ0000300785	2. 12. 2015	CZKm	176.24
ČSOB IC INDEXOVÝ I.	CZ0000300777	19. 11. 2015	CZKm	391.75
ČSOB Investiční certifikát Unit link VI.	CZ0000300793	21. 12. 2015	CZKm	572.70
ČSOB Investiční certifikát XLIII. (Eurostoxx50)	CZ0000300819	9. 12. 2015	EURm	3.59
ČSOB Investiční certifikát XLIV. (Eurostoxx50)	CZ0000300827	16. 12. 2015	USDm	3.06
Defensive SX5E 4,8 2023	CZ0000300835	30. 12. 2015	CZKm	217.77
Defensive SX5E 4,8 2023 II	CZ0000300868	3. 2. 2016	CZKm	259.82
Autocall SX5E 5,9 2021	CZ0000300850	5. 2. 2016	CZKm	399.90
Participation SX5E 2021	CZ0000300843	9. 2. 2016	CZKm	62.60
ČSOB Investiční certifikát Unit link VII.	CZ0000300884	22. 2. 2016	CZKm	763.20
Participation SX7P 2021	CZ0000300892	16. 3. 2016	CZKm	39.89
ČSOB Investiční certifikát Unit link VIII.	CZ0000300900	11. 4. 2016	CZKm	194.83
ČSOB Investiční certifikát CLN 2020	CZ0000300967	11. 4. 2016	CZKm	500.00
Defensive SX5E 5 2023	CZ0000300926	13. 4. 2016	CZKm	290.16
Worst of Banks 6 2021	CZ0000300934	20. 4. 2016	CZKm	112.20
ČSOB Investiční certifikát Unit link IX.	CZ0000300959	24. 5. 2016	CZKm	191.50
Dividend basket 7 2023	CZ0000300975	18. 5. 2016	CZKm	161.35
Worst of US Dividend Basket 8 2021	CZ0000301007	22. 6. 2016	CZKm	111.60
ČSOB Investiční certifikát Unit link X.	CZ0000300983	15. 7. 2016	CZKm	124.30
Defensive SX5E 5,2 2023	CZ0000301015	22. 6. 2016	CZKm	104.77
ČSOB Investiční certifikát Unit link XI.	CZ0000301031	12. 9. 2016	CZKm	116.25
Evropská inflace a Euro Stoxx 50 2021	CZ0000301049	21. 9. 2016	CZKm	82.15
2nd Worst of IT Basket 6,5 2021	CZ0000301056	21. 9. 2016	CZKm	115.45
ČSOB Investiční certifikát Unit link XII.	CZ0000301064	24. 10. 2016	CZKm	324.95
Solactive Participation 2021	CZ0000301072	3. 11. 2016	CZKm	220.34
Defensive SX5E 4,6 2024	CZ0000301122	30. 11. 2016	CZKm	179.70
ČSOB Investiční certifikát Unit link XIII.	CZ0000301130	29. 12. 2016	CZKm	582.26
ČSOB Investiční certifikát Unit link XIV.	CZ0000301148	12. 12. 2016	CZKm	502.41
Healthcare Allergan	CZ0000301155	29. 12. 2016	CZKm	18.50
Gold Miners	CZ0000301163	21. 12. 2016	CZKm	194.70
Defensive SX5E 4,6 2024 II.	CZ0000301171	29. 12. 2016	CZKm	118.09
ČSOB Investiční certifikát Unit link XV.	CZ0000301189	30. 12. 2016	CZKm	129.80

**In the first four months 2017\***, ČSOB issued the following investment certificates issues in the Czech Republic:

Issue Name	ISIN	Issue Date	Volume of Investment Certificates Issued (Nominal Value)	
ČSOB IC Unit link XVI.	CZK0000301197	10. 2. 2017	CZKm	191.23
Defensive Euro iSTOXX 70 EWD5 4 2024	CZK0000301205	8. 3. 2017	CZKm	248.60
Autocall Euro iSTOXX 70 EWD5 4 2024	CZK0000301213	8. 3. 2017	CZKm	430.36
ČSOB IC Unit link XVII.	CZK0000301239	10. 3. 2017	CZKm	125.18
Defensive Eurostoxx 4,6 2024 III.	CZK0000301254	15. 3. 2017	CZKm	308.85
NYSE Arca Gold BUGS 5,1 2022	CZK0000301288	15. 3. 2017	CZKm	173.55
ČSOB TOP 70 EVROPSKÝCH SPOLEČNOSTÍ 1	CZK0000301247	5. 4. 2017	CZKm	316.61
ČSOB Investiční certifikát Unit link XVIII.	CZK0000301304	12. 4. 2017	CZKm	103.47

\* Issued until 12 April 2017.

All ČSOB's investment certificates are unlisted (not publicly tradable on any official regulated market in either an EU member state, or an EEC member state).

The bond issuance program's prospectus and the prospectus of investment certificates, amendments thereto and pricing supplements are available at ČSOB's website [www.csob.cz](http://www.csob.cz).

The purpose of the issuance of bonds and of investment certificates by ČSOB is mainly to enlarge the offer of investment products for the Bank's clients.

## Activity of ČSOB

**ČSOB is active as a universal bank in the Czech Republic.**

**As a legal entity subject to the Czech law, ČSOB follows the applicable legislation in force in the territory of the Czech Republic.** Its activities are regulated primarily under the Banking Act, the Capital Market Undertakings Act and by the Corporations Act. **A single banking licence** is of fundamental importance for ČSOB's business activities. ČSOB is also authorized to provide services of a tied insurance intermediary and is participant of the Central Depository.

### Main Areas of Activities

**ČSOB's Scope of Business is defined in the Articles of Association of ČSOB** (in the part III. Scope of Business).

ČSOB, being a universal bank, carries out banking transactions and renders financial services according to the generally binding legal regulations of the Czech Republic regulating the domestic and foreign activities of banks. In particular, **it accepts deposits from the public and provides loans.**

**In addition to these basic services, ČSOB is authorized to carry out the following activities according to the applicable Czech legal regulations:**

- Investment in securities on the Bank's own account,
- Financial leasing,
- Payments and clearance,

- Issuance and administration of payment instruments,
- Provision of guarantees,
- Issuance of letters of credit,
- Provision of collection services,
- Provision of all investment services according to a special law,
- Issuance of mortgage bonds,
- Financial brokerage,
- Provision of depository services,
- Exchange office services (purchase of foreign exchange),
- Provision of banking information,
- Trading in foreign exchange values and gold on the Bank's own account or on a client's account,
- Rental of safe-deposit boxes,
- Activities directly related to the activities mentioned above, and
- Activities carried out for other parties if they relate to the running of the company and operation of other banks, financial institutions and enterprises providing ancillary banking services, controlled by the company.

## Significant Contracts

**Out of the ordinary course of ČSOB's business, the Bank has entered into no contracts** which could result in any group member being under an obligation or entitlement that is material to ČSOB's ability to meet its obligation to security holders in respect of the securities being issued.

ČSOB is unaware of any agreements in which it is a contracting party and that come into effect, are amended, or the efficiency of which terminates in consequence of any changes in the control circumstances implied by an offer for takeover.

On 1 September 2005, ČSOB and Česká pošta, s.p. (the "Czech Post Office") entered into the Agreement on the Provision of Services, which governs the cooperation between ČSOB and the Czech Post Office with respect to the distribution of ČSOB products in the network of post offices in the Czech Republic under the PSB brand. The Agreement on the Provision of Services is concluded for a fixed period and shall be effective until the end of 2017.

## Trademarks, Licenses, Patents

Being aware of the ever-growing importance of intellectual property as a vital and integral part of the modern society, ČSOB pays extraordinary attention to the intellectual property rights and their protection.

ČSOB is the applicant/owner of more than a hundred **trademarks** registered with the trademark authorities established to protect industrial or other intellectual property rights and uses the trademarks for product and service identification when performing its business activities.

ČSOB is a holder of many **licenses**, mainly software products licenses, to support ČSOB's business activities.

ČSOB is not a **patent** applicant/owner.



## Governmental, Legal or Arbitration Proceedings

which may have, or have had in the recent past, significant effects on ČSOB's and / or the ČSOB group's financial position or profitability

### Information on Court Disputes

For information on court disputes please refer to the Separate Financial Statements for the year 2016 (Notes 27 and 33) and to the Consolidated Financial Statements for the year 2016 (Notes 29 and 35).

The most significant ČSOB's court disputes as at 31 December 2016, are shown in the following table including the dispute amount (with accessories).

### Litigation against ČSOB (the Defendant)

Counterparty of the Dispute	Liability (CZK m)
ICEC-HOLDING, a.s., Boleslavova 710/19, Ostrava	21,475

According to ČSOB, this legal dispute does not constitute any risk, given its absolute unreasonableness. If, however it is improbable situation, ČSOB would be obliged to provide any payment on the basis of the legally binding decision in this dispute, ČSOB would consider to claim the reimbursement of such payment from CNB, under the Agreement and Indemnity concluded in connection with the sell of the IPB Enterprise.

## Expenses on Research and Development

In 2016, ČSOB had outlays of CZK 104 m for research and development (2015: CZK 142 m). Most of these outlays were related to development studies and implementation of individual projects, particularly in the area of information technologies and systems, including development of internet applications. Besides, after insourcing of ICT activities on 31 December 2015, ČSOB had additional outlays of CZK 1,268 m in 2016 related to investments into large information technologies projects and smaller development of existing applications (2015: these costs were included in the overall ICT invoice from KBC Group Czech Branch).

## Other Information

### Remuneration Charged by Auditors for 2016

Information in accordance with Section 118 (4) (k) of the Act No. 256/2004 Coll., Capital Market Undertakings Act

Type of Service (CZKths; excluding VAT*)	ČSOB	Consolidated ČSOB Unit
Statutory audit of annual financial statements	18,899	27,227
Other assurance services	129	2,317
Tax advisory	0	380
Other non-audit services	21	1,261
Training / consultation	79	85
<b>Total</b>	<b>19,128</b>	<b>31,270</b>

\* Published information includes relevant part of VAT, which is not deductible.

## Contribution to the Securities Traders Guarantee Fund

Information in accordance with Section 16 (1) of the Act No. 256/2004 Coll., Capital Market Undertakings Act

As a securities trader, ČSOB contributes to the Guarantee Fund, which ensures the guarantee system from which compensation is paid to the clients of a securities trader that is not able to fulfil its obligations to its clients.

Contribution to the Securities Traders Guarantee Fund for 2016 (CZKthš)	ČSOB	Consolidated ČSOB Unit*
Basis for calculation of the contribution	959,317	1,181,793
<b>The contribution</b>	<b>19,186</b>	<b>23,636</b>

\* Including Patria Finance (the company started to be consolidated from 1 January 2015).

Contribution of ČSOB AM (CZK 1,585 thš) is not included in the total amount of the contribution of the consolidated ČSOB Unit, since the company is included in the Consolidated Financial Statements of the ČSOB group using the equity method of consolidation in 2016.

## Information Published within this Annual Report

Information	Reference <sup>1)</sup>
Important Events and Significant Changes in 2016	Report of the Board of Directors Corporate Governance Policy Note 3 <sup>2)</sup>
New Products and Services Introduced in 2016	Report of the Board of Directors
Description of Markets where ČSOB Competes	Company Profile Report of the Board of Directors
Profit Distribution	Note 13
Activities Undertaken in the Area of Environmental Protection <sup>3)</sup>	Corporate Social Responsibility
Information on Entities Included into the ČSOB Consolidated Financial Statements as at 31 December 2016	Companies of the ČSOB group Note 3 <sup>2)</sup>
Expected Economic and Financial Situation of ČSOB in 2017	Report of the Board of Directors

1) The content refers to another section of this Annual Report or to a note in Notes to the Separate Financial Statements for the year 2016 (unless stated otherwise).

2) The content refers to a note in Notes to the Consolidated Financial Statements for the year 2016.

3) Together with this Annual Report, ČSOB also publishes the ČSOB Group Report to Society 2016.

## Annex to Additional Information

Information according to Annex 14 of the Decree No. 163/2014 Coll., on the Performance of the Activities of Banks, Credit Unions and Investment Firms

### Events after the Reporting Period

Chapter	Part
Corporate Governance	Managing and Supervisory Bodies, ČSOB's Organisation Chart
Additional Information	Bonds and Investment Certificates
Notes to the Consolidated Financial Statements for the year 2016	Events after the Reporting Period (Note 39)
Notes to the Separate Financial Statements for the year 2016	Events after the Reporting Period (Note 37)

## Information on the Publication of the ČSOB Annual Report 2016

**ČSOB will publish its Annual Report 2016 on its Internet website at [www.csob.cz](http://www.csob.cz).**

The **Czech National Bank** will add the ČSOB Annual Report 2016 to the collection of deeds of the **Register of Companies** pursuant to Section 21a of the Accounting Act.

Information in accordance with Section 99 of Decree No. 163/2014 Coll., on the Performance of the Activities of Banks, Credit Unions and Investment Firms

Annual reports and other obligatory information are available (by the date of release of this Annual Report) on ČSOB's Internet website in the section ČSOB – **Obligatory Published Information** (Povinně uveřejňované informace):

<https://www.csob.cz/portal/about-csob/obligatory-published-information#vyrocni-zpravy>.

## Annex to Additional Information

### Information according to Annex 14 of Decree No. 163/2014 Coll.,

on the Performance of the Activities of Banks, Credit Unions and Investment Firms

#### Information about Capital and Capital Requirements pursuant to Article 437 (1) (a) of Regulation (EU) 575/2013

		the Bank	Regulated Cons. Unit
(CZKths)		31. 12. 2016	31. 12. 2016
Items from Statement of Financial Position	<b>Total Shareholders' Equity</b>	<b>81,346,725</b>	<b>88,550,499</b>
	Share capital	5,855,000	5,855,000
	Share premium	20,092,666	20,928,552
	Accumulated Other comprehensive income	3,817,472	4,201,649
	Reserve funds	18,686,648	18,686,648
	Retained earnings for the previous periods	17,350,797	23,739,872
	Own shares	0	0
	Net profit for the period	15,544,142	15,138,779
	Non-controlling interest	0	0
Adjustments to CET1	<b>Total Adjustments to CET1</b>	<b>(17,763,399)</b>	<b>(19,570,004)</b>
	Gains / (losses) on hedging instruments (Cash Flow Hedging)	(1,973,124)	(1,973,124)
	Additional value adjustment	(217,215)	(204,841)
	Goodwill	(2,211,104)	(2,063,994)
	Other intangible assets, net of tax	(2,559,839)	(3,656,804)
	Insufficient coverage of expected credit losses (lack of provisions)	(655,402)	(1,524,526)
	Unusable profit	(10,146,715)	(10,146,715)
	Non-controlling interest	0	0
Other transitional adjustments to CET 1	0	0	
Tier 2 Capital	<b>Total Tier 2 Capital</b>	<b>532,676</b>	<b>1,311,293</b>
	IRB Excess of provisions over expected losses eligible	532,676	1,311,293
	<b>Total Capital</b>	<b>64,116,002</b>	<b>70,291,789</b>
	<b>Tier 1 (T1) Capital</b>	<b>63,583,326</b>	<b>68,980,495</b>
	<b>Common Equity Tier 1 (CET1) Capital</b>	<b>63,583,326</b>	<b>68,980,495</b>
	<b>Tier 2 (T2) Capital</b>	<b>532,676</b>	<b>1,311,293</b>

## Information about Capital and Capital Requirements pursuant to Article 438 (c) to (f) of Regulation (EU) 575/2013

		the Bank	Regulated Cons. Unit
(CZKthns)		31. 12. 2016	31. 12. 2016
In the case of institutions that calculate the exposure values according to part three title II chapter 2.8% of the exposure value for each category of exposure indicated in Article 112 of Regulation (EU) 575/2013	Exposures to central governments or central banks	0	0
	Exposures to regional governments or local authorities	0	0
	Exposures to public sector entities	0	14
	Exposures to multilateral development banks	0	0
	Exposures to international organisations	0	0
	Exposures to institutions	0	23,065
	Exposures to corporates	0	538,332
	Retail exposures	0	79,387
	Exposures secured by mortgages on immovable property	0	63,769
	Exposures in default	0	44,688
	Exposures associated with particularly high risk	0	0
	Exposures in the form of covered bonds	0	0
	Items representing securitisation positions	0	0
	Exposures to institutions and corporates with a short-term credit assessment	0	0
	Exposures in the form of units or shares in collective investment undertakings	0	0
	Equity exposures	3,732,148	78,208
	Other items	0	289,725
Capital requirements calculated according to Article 92 (3) (b) and (c) of Regulation (EU) 575/2013	For position risk	215,392	193,884
	For large exposures exceeding the limits set in Articles 395 to 401, if the institution is permitted to exceed these limits	0	0
	For currency risk	0	132
	For settlement risk	0	0
	For commodity risk	0	0
Capital requirements calculated according to part three title III chapters 2, 3 and 4 of Regulation (EU) 575/2013 and made available separately	Capital requirement pursuant to title III chapter 2	0	0
	Capital requirement pursuant to title III chapter 3	3,969,660	4,492,446
	Capital requirement pursuant to title III chapter 4	0	0
In the case of institutions that calculate the exposure values according to part three title II chapter 3.8% of the exposure value for each category of exposure indicated in Article 147.	Exposures to central governments or central banks	794,928	858,278
	Exposures to institutions	3,038,323	658,872
	Exposures to corporates	10,728,043	10,332,995
	Retail exposures	1,666,282	9,223,179
	Equity exposures	0	0
	Items representing securitisation positions	0	0
	Other assets not having the character of a credit liability	1,887,155	2,154,495
In the case of the retail exposure category, this requirement is used for each category of exposure that corresponds to differing correlation according to Article 154 (1) to (4) of Regulation (EU) 575/2013.	Equity exposures	0	0
	Items representing securitisation positions	0	0
	Other assets not having the character of a credit liability	1,887,155	2,154,495
	Equity exposures not traded on regulated markets in sufficiently diversified portfolios and other exposures	0	0
	Exposures that in the area of capital requirements are subject to transitional supervision rules	0	0
In the case of the equity exposures category this requirement is used for	Equity exposures traded on regulated markets	0	0
	Equity exposures not traded on regulated markets in sufficiently diversified portfolios and other exposures	0	0
	Exposures that in the area of capital requirements are subject to transitional supervision rules	0	0
	Exposures that in the area of capital requirements are subject to provisions relating to retention of legal effects	0	0
Each of the approaches indicated in Article 155	0	0	
* Risk exposure for credit valuation adjustment		354,441	354,441
* Risk exposure amount for Position, foreign exchange and commodities risks under internal models		931,729	931,729

\* This items was added for observance of required reporting CNB.

## Capital Ratios

	the Bank 31. 12. 2016	Regulated Cons. Unit 31. 12. 2016
Capital ratio for Equity capital Tier 1	18.62%	18.20%
Capital ratio for Tier 1 capital	18.62%	18.20%
Capital ratio for Total capital	18.78%	18.55%

## Ratios Indicators

	the Bank 31. 12. 2016
Return on average assets (ROAA)	1.46%
Return on average Tier 1 capital (ROAE)	26.34%
Assets per employee*	CZKths 144,963
Administrative costs per employee*	CZKths 1,720
Profit after tax per employee*	CZKths 2,139

\* According to CNB's methodology (Registered number of employees).

## DOCUMENTS

### Sworn Statement

#### Persons Responsible for the ČSOB Annual Report 2016

hereby declare that, to their best knowledge, the ČSOB Annual Report 2016 gives a true and fair account of ČSOB and its consolidation unit's financial situation, business activities and business results achieved in the previous financial year as well as the outlook for the future trends in the financial situation, business activities and business results.

In Prague, 20 April 2017

Československá obchodní banka, a. s.



**John Arthur Hollows**

Chairman of the Board of Directors



**Jiří Vévoda**

Member of the Board of Directors



# Independent Auditor's Report



## *Independent auditor's report*

**to the shareholder of Československá obchodní banka, a. s.**

### *Opinion*

We have audited:

- the consolidated financial statements of Československá obchodní banka, a. s., with its registered office at Radlická 333/150, Praha 5 ("the Company") and its subsidiaries (together "the Group") prepared in accordance with International Financial Reporting Standards as adopted by the European Union, which comprise the consolidated statement of financial position as at 31 December 2016, the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended and notes to the consolidated financial statements, which include significant accounting policies and other explanatory information, and
- the separate financial statements of the Company prepared in accordance with International Financial Reporting Standards as adopted by the European Union, which comprise statement of financial position as at 31 December 2016, the statements of income, comprehensive income, changes in equity and cash flows for the year then ended and notes to the separate financial statements, which include significant accounting policies and other explanatory information.

In our opinion:

- the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2016, 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 European Union, and
- the separate financial statements give a true and fair view of the financial position of the Company standing alone as at 31 December 2016, of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

The consolidated and separate financial statements are further referred to together as financial statements.

### *Basis for Opinion*

We conducted our audit in accordance with the Act on Auditors and Standards on Auditing of the Chamber of Auditors of the Czech Republic. These standards consist of International Standards on Auditing (ISAs) which may be supplemented and modified by related application guidance. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Group and the Company in accordance with the Act on Auditors and Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) and accepted by the Chamber of Auditors of the Czech Republic, and we have fulfilled our other ethical responsibilities in accordance with these regulations. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Other Information*

In compliance with Section 2(b) of the Act on Auditors, the other information comprises the information included in the Annual Report other than the financial statements and auditor's report thereon. The Board of Directors is responsible for the other information.

PricewaterhouseCoopers Audit, s.r.o., Hvězdova 1734/2c, 140 00 Prague 4, Czech Republic  
T: +420 251 151 111, F: +420 251 156 111, [www.pwc.com/cz](http://www.pwc.com/cz)

PricewaterhouseCoopers Audit, s.r.o., registered seat Hvězdova 1734/2c, 140 00 Prague 4, Czech Republic, Identification Number: 40765521, registered with the Commercial Register kept by the Municipal Court in Prague, Section C, Insert 3637, and in the Register of Audit Companies with the Chamber of Auditors of the Czech Republic under Evidence No 021.



**Shareholder of Československá obchodní banka, a. s.  
Independent auditor's report**

Our opinion on the financial statements does not cover the other information. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge about the Group and the Company obtained in the audit or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law and regulation, in particular, whether the other information complies with law and regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

- The other information describing the facts that are also presented in the financial statements is, in all material respects, consistent with the financial statements; and
- The other information is prepared in compliance with applicable law and regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Group and the Company obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.

*Responsibilities of the Board of Directors and Supervisory Board for the Financial Statements*

The Board of Directors is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Board of Directors is responsible for assessing the Group and the Company'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 the Board of Directors either intends to liquidate the Group or the Company or to cease operations, or has no realistic alternative but to do so.

The Supervisory Board is responsible for overseeing the financial reporting process.

*Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the above stated requirements 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 financial statements.

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

- Identify and assess the risks of material misstatement of the 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 controls.
- Obtain an understanding of internal controls 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 and the Company's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.



**Shareholder of Československá obchodní banka, a. s.  
Independent auditor's report**

- Conclude on the appropriateness of the Board of Directors' 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 and the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group or the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the notes, and whether the 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 the Board of Directors, Supervisory Board and Audit Committee 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.

20 April 2017

*Pracovní ústavem Coopers Audit, s. r. o.*

represented by

*Marek Richter*

Marek Richter  
Partner and Statutory Auditor, Evidence No. 1800

Note

Our report has been prepared in the Czech language and in English. In all matters of interpretation of information, views or opinions, the Czech version of our report takes precedence over the English version.

## ABBREVIATIONS

Abbreviation	Business Company
ČSOB the Bank	Československá obchodní banka, a. s.
ČSOB group	group of companies of the ČSOB group (not a legal entity)
PSB	Poštovní spořitelna (Postal Savings Bank; part of ČSOB)

Abbreviation	Business Company
BANIT	Bankovní informační technologie, s.r.o.
Bausparkasse Schwäbisch Hall	Bausparkasse Schwäbisch Hall AG
CBCB	CBCB - Czech Banking Credit Bureau, a.s.
Centrum Radlická	Centrum Radlická a.s.
CNB	Czech National Bank
Czech Post	Česká pošta, s.p.
CZSO	Czech Statistical Office
ČMSS	Českomoravská stavební spořitelna, a.s.
ČSOB Advisory	ČSOB Advisory, a.s.
ČSOB AM / ČSOB Asset Management	ČSOB Asset Management, a.s., investment company
ČSOB Factoring	ČSOB Factoring, a.s.
ČSOB Leasing	ČSOB Leasing, a.s.
ČSOB Leasing pojišťovací makléř	ČSOB Leasing pojišťovací makléř, s.r.o.
ČSOB PF Stabilita	ČSOB Penzijní fond Stabilita, a. s., a member of the ČSOB group
ČSOB PS / ČSOB Penzijní společnost	ČSOB Penzijní společnost, a. s., a member of the ČSOB group
ČSOB Pojišťovna	ČSOB Pojišťovna, a. s., a member of the ČSOB holding
ČSOB Pojišťovací servis	ČSOB Pojišťovací servis, s.r.o., a member of the ČSOB holding
ČSOB Property fund	ČSOB Property fund, a.s.
ČSOB SK	Československá obchodní banka, a. s. (Slovak Republic)
Hypoteční banka	Hypoteční banka, a.s.
IPB	Investiční a Poštovní banka, a.s.
KBC Bank	KBC Bank NV
KBC Group	KBC Group NV (legal entity)
KBC group	group of companies of the KBC Group NV
KBC Group Czech Branch	KBC Group NV Czech Branch, organizational unit
KBC Insurance / KBC Verzekeringen	KBC Insurance NV (i.e. KBC Verzekeringen NV)
KBC Lease Holding	KBC Lease Holding NV
KBC Participations Renta C	KBC Participations Renta C SA
KBC Securities	KBC Securities NV
Merrion Properties	Merrion Properties s.r.o.
MF CR	Ministry of Finance of the Czech Republic
Motokov	MOTOKOV a.s. in liquidation
Patria Corporate Finance	Patria Corporate Finance, a.s.
Patria Finance	Patria Finance, a.s.
Patria group	group of companies of parent company Patria Online (not a legal entity)
Patria investiční společnost / Patria IS	Patria investiční společnost, a.s.
Patria Online	Patria Online, a.s.
Radlice Rozvojová	Radlice Rozvojová, a.s.
SousedecZ	SousedecZ s.r.o.
Top-Pojištění	Top-Pojištění.cz s.r.o.
Transformed fund / Transformed pension fund	Transformovaný fond Stabilita ČSOB Penzijní společnosti, a. s., a member of the ČSOB group

## FINANCIAL CALENDAR

### Financial Calendar for 2017

ČSOB Group Unaudited Financial Results Releases  
(according to EU IFRS)

Financial Results		Date of Release
as at 31 December 2016	4Q / FY 2016	9 February 2017
as at 31 March 2017	1Q 2017	11 May 2017
as at 30 June 2017	2Q / 1H 2017	10 August 2017
as at 30 September 2017	3Q / 9M 2017	16 November 2017
as at 31 December 2017	4Q / FY 2017	February 2018

Note:

*This schedule is indicative only; terms might be subject to change during the year.*

## CONTACT DETAILS

### Investor Relations

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Československá obchodní banka, a. s.

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Radlická 333/150

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150 57 Praha 5

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Czech Republic

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Tel.: +420 224 114 106

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E-mail: [investor.relations@csob.cz](mailto:investor.relations@csob.cz)

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The 2016 ČSOB Annual Report was released in electronic version at [www.csob.cz](http://www.csob.cz) on 28 April 2017.

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