# ANNUAL REPORT 2013

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Československá obchodní banka, a. s.

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| | |
|---|---|
| Business name: | **Československá obchodní banka, a. s.** |
| 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)<br>CZ00001350 (for other taxes) |
| Bank code: | 0300 |
| SWIFT: | CEKOCZPP |
| Telephone: | +420 224 111 111 |
| E-mail: | info@csob.cz |
| Internet address: | http://www.csob.cz |
| Data box: | 8qvdk3s |
| Supervisory body: | Czech National Bank (CNB),<br>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 | 2013 | 2012 | 2011 |
|---|---|---|---|
| **Financial Statements Figures** | | | |
| *Balance sheet at the year end (CZKm)* | | | |
| Total assets | 1,034,830 | 937,174 | 936,593 |
| Loans and receivables | 509,256 | 479,516 | 449,291 |
| Deposits received from other than credit institutions | 660,342 | 629,622 | 612,160 |
| Debt securities in issue | 30,190 | 30,330 | 23,295 |
| Shareholders' equity 1) | 80,249 | 73,930 | 60,303 |
| *Statement of income (CZKm)* | | | |
| Operating income | 32,997 | 35,015 | 33,586 |
| Operating expenses | 15,531 | 16,087 | 15,699 |
| Impairment of loans and receivables | 1,378 | 1,631 | 1,822 |
| Profit before tax | 16,071 | 17,539 | 12,970 |
| Profit for the year 1) | 13,658 | 15,291 | 11,172 |
| **Ratios** (%) | | | |
| Return on average equity (ROAE) 2) | 18.2 | 22.8 | 17.9 |
| Return on average assets (ROAA) 2) | 1.42 | 1.63 | 1.23 |
| Cost / income ratio 2) | 47.1 | 45.9 | 46.7 |
| Capital adequacy ratio – Bank 3) | 15.3 | 14.4 | 13.6 |
| Capital adequacy ratio – ČSOB group 3) | 15.6 | 15.2 | 15.5 |
| Leverage ratio 4) | 5.46 | 4.73 | 3.96 |
| Net stable funding ratio 4) | 135.7 | 133.2 | 133.6 |
| Loan-to-deposit ratio 2) | 77.0 | 75.2 | 72.7 |
| **General Information** (as at the year-end) | | | |
| Number of employees – ČSOB group 5) | 7,553 | 7,801 | 7,769 |
| Number of clients – Bank (thousands) | 2,947 | 3,054 | 3,096 |
| Number of branches – Bank 6) | 319 | 322 | 314 |
| Number of ATMs 7) | 1,006 | 914 | 831 |
| **Financial Market Rates** 8) | | | |
| CZK/EUR exchange rate (average) | 26.0 | 25.1 | 24.6 |
| Interest rate (three month PRIBOR; average; in %) | 0.46 | 1.00 | 1.19 |

| Credit Rating 9) (as at 31 December 2013) | Long-term Rating Effective since | Long-term | Short-term | Financial Strength | Viability Rating | Support |
|---|---|---|---|---|---|---|
| Moody's | 20 June 2012 | A2 | Prime-1 | C- | | |
| Fitch | 3 February 2012 | BBB+ | F2 | | bbb+ | 2 |

*Some 2011 items were reclassified to allow for year-on-year comparison.*

1) *Attributable to equity holders of the Bank.*
2) *As at the year end; for definition please refer to page 6.*
3) *According to the CNB methodology; based on Basel II; as at the year end. End of period regulatory capital (ratios) does not reflect retained earnings until shareholders' approval of the audited financial statements in the following year.*
4) *According to Basel III. For definitions, please refer to the Report of the Board of Directors.*
5) *Full-time equivalent employees.*
6) *Includes ČSOB branches and Era Financial Centers, i.e. without approximately 3,100 post offices.*
7) *Includes the Bank's ATMs, i.e. without 6,040 payment terminals enabling cashback in Albert, COOP and Family drogerie stores and ČEPRO EuroOil petrol stations.*
8) *Source: CNB.*
9) *Credit ratings as of the date of this Annual Report are part of the Report of the Board of Directors.*

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## Ladies and gentlemen, dear friends and colleagues,

I am very happy that the ČSOB group has achieved several important milestones in 2013. **Loans** to clients exceeded CZK 500 bn and mortgages stopped just short of CZK 200 bn. We managed to maintain the excellent quality of the loan portfolio: the credit cost ratio was at 0.25% as at the year end, which is way below the through-the-cycle level. We were able to achieve such results thanks to an active approach to client service on the part of the bank and prudence and admirable discipline on the part of our clients. As we have proved over the past years, the capability to extend credit was the cornerstone of our business – and we will continue to build on it in the future.

Personally, I am very proud that clients entrust more and more of their **deposits** into our custody. Ladies and gentlemen, I consider this to be proof of trust in our group. The loan to deposit ratio reached 77% and illustrates the high liquidity position of our group. I was also happy to see that clients had returned to mutual funds after the crisis.

In 2013, we managed to find more savings and improved the efficiency; costs were adjusted to the expected revenues. Notwithstanding this efficiency mode, we invest into innovations and improving our client care.

We worked on our business model in 2013 with a vision for the "new digital normal" of the Y generation. We are creating a bank that clients trust with their funds and data. We are learning to efficiently assess this data. Based on the new information we will be able to provide our clients with services more tailored to their self-confidence, needs and life situation. We are not at the very beginning of these activities and I am looking forward to doing much more in this respect in 2014 and beyond.

**Teams of our people** represent a most valuable **capital** and are the third area which receives the same focus as granting loans and our business model. In 2013, we have co-created and implemented the KBC strategy called PEARL.

ČSOB also boosted its capital structure in 2013. We have retained part of our earnings and replaced subordinated debt with Tier 1 share capital. Therefore we meet Basel III requirements with a margin and well in advance.

Ladies and gentlemen, let me conclude by expressing my joy and thank to all of our people for their outstanding job and to our clients for their trust which I cherish so much.

**Pavel Kavánek**
Chairman of the Board of Directors
and Chief Executive Officer

## General Economic and Market Indicators

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

During last five years the Czech economy went through two recessions, of which the second one finished only at the beginning of 2013. Following the significant downturn at the beginning of the year, there was a gradual recovery driven mainly by export oriented manufacturing industry, more precisely the automotive industry. Record growth of the economy at the end of the year was driven to a large extent by extraordinary effects such as the higher collection of excise tax. Domestic consumer demand started to recover during the year and finally investments started to grow. However, not even three quarters of economic growth managed to compensate for the deep gross domestic product (GDP) decline from the beginning of the year. Thus, weaker performance was recorded essentially in all economic sectors in 2013.

While the Czech economy returned to a growth trajectory, inflation gradually declined to a final figure of 1.4%. Low inflation allowed the Central Bank to keep its main interest rate at record low level (0.05%) during the whole year. On top of that, in November, it proceeded with an extraordinary intervention in the form of a significant depreciation of the Czech currency and kept the rate above 27 CZK / EUR. The new intervention regime has been introduced with the aim to avoid risk of deflation in 2014 and to support the economic growth of the Czech Republic.

Together with the gradual recovery of the economy, the situation on the labour market started to stabilize at the end of 2013. The unemployment rate remained at last year's level, however the trend of average real wages decline has not stopped yet.

The State Budget finished 2013 with a much better result than was anticipated. Therefore the position of the Czech Republic on the financial market inter alia remained very good. The Ministry of Finance exploited the very low bond yields to strengthen its strong liquid position, which was further improved by the partial release of existing reserves for short term financing of the government debt. In 2013, the Czech balance of payments improved as the current account deficit decreased to -1.4% of GDP thanks to record result in foreign trade.

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

| Indicator [1] | Measurement Unit | 2013 | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|---|---|
| Nominal GDP | CZKbn | 3,884 | 3,846 | 3,823 | 3,791 | 3,759 |
| Real GDP growth | % change, Y / Y | (0.9) | (1.0) | 1.8 | 2.5 | (4.5) |
| Real GDP per capita | CZKths | 337.9 | 341.1 | 345.1 | 338.2 | 330.9 |
| Real GDP growth per capita | % change, Y / Y | (0.9) | (1.1) | 2.0 | 2.2 | (5.1) |
| Inflation rate (CPI) | %, year end | 1.4 | 2.4 | 2.4 | 2.3 | 1.0 |
| Unemployment rate | %, average | 7.0 | 7.0 | 6.7 | 7.3 | 6.7 |
| General government budget balance / Nominal GDP | % | (1.4) | (4.2) | (3.2) | (4.7) | (5.8) |
| General government debt | CZKbn | 1,788.2 | 1,775.4 | 1,583.3 | 1,454.4 | 1,299.3 |
| General government debt / Nominal GDP | % | 46.0 | 46.2 | 41.4 | 38.4 | 34.6 |
| Exports of goods and services [2] | % change, Y / Y | 1.6 | 7.9 | 9.5 | 14.8 | (9.9) |
| Imports of goods and services [2] | % change, Y / Y | 0.7 | 6.1 | 9.2 | 17.5 | (12.9) |
| Trade balance / Nominal GDP [2] | % | 4.8 | 3.9 | 2.4 | 1.4 | 2.3 |
| Interest rate (three month PRIBOR) [2] | %, average | 0.5 | 1.0 | 1.2 | 1.3 | 2.2 |
| CZK / EUR exchange rate [2] | average | 26.0 | 25.1 | 24.6 | 25.3 | 26.4 |

*Source:*
*1) CZSO, unless stated otherwise.*
*2) CNB.*

## Highlights and Main Events

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

**Key figures of the ČSOB group in 2013:**

- In 2013, the ČSOB group's **net profit** attributable to the owners of the parent according to EU IFRS was **CZK 13.7 bn** (-11% year on year). Adjusted for the sale of a stake in ČSOB Pojišťovna in 4Q 2012, the decline was 3% year on year.
- **The credit portfolio** grew further and reached **CZK 508.5 bn** (+7% year on year), especially thanks to mortgages, SME and corporate loans. **Group deposits** increased to **CZK 660.3 bn** (+5% year on year).

**The ČSOB group closely manages the credit risk and maintains strong capital and liquidity positions** as reflected by the following 2013 year-end figures:

- **Credit costs** decreased in 2013 both in absolute and relative terms. The credit cost ratio (CCR) stood at **25 bps**.
- The **loan to deposit** ratio increased to **77.0%** and the **Tier 1** ratio increased notably to **15.6%**.
- ČSOB had no **exposure to peripheral Europe** in 2013.
- In July 2013, a **dividend per share of CZK 45.50** was distributed from the non-consolidated net profit for the year 2012; the total amount was CZK 13.3 bn.

**Changes in ownership interests**

- With the effect on 1 January 2013, ČSOB PF Stabilita was transformed to ČSOB Penzijní společnost, a. s., a member of the ČSOB group which conducts pension insurance through a transformed fund. Since 1 January 2013, ČSOB Penzijní společnost also offers pension savings through pension funds and supplementary pension savings through various participations funds with different investment strategies.

**Share capital**

On 11 July 2013, KBC Bank NV as ČSOB's sole shareholder decided to increase the share capital of ČSOB by CZK 20 from current CZK 5,855,000,000 to CZK 5,855,000,020 as follows:

- one piece of ordinary bearer share with a nominal value of CZK 20 was subscribed,
- issue price of the subscribed share is CZK 8,000,000,000, whereas CZK 7,999,999,980 is a share premium.

**Subordinated debt**

To support the capital structure of its group, ČSOB received subordinated debt in the nominal amount of CZK 12 bn in two tranches: CZK 5 bn in September 2006 with the maturity date of 29 September 2016 and CZK 7 bn in February 2007 with the maturity date of 28 March 2017.

In September 2012, ČSOB repaid in advance CZK 4 bn of the first tranche of subordinated debt. ČSOB repaid the remaining CZK 8 bn of subordinated debt on 30 August 2013.

**Business Unit Czech Republic**

Effective as of 1 January 2013, KBC Group has organized its core markets activities into three business units – Belgium, Czech Republic and International Markets. Business Unit Czech Republic contains all KBC's operations in the Czech Republic, namely the ČSOB group, ČSOB Pojišťovna, ČSOB AM/IS and Patria Finance.

For **personnel changes in the ČSOB's bodies** please refer to the Corporate Governance section of this Annual Report.

## Financial Ratios

| | 2013 (%) | 2012 (%) | Y/Y change (pp) |
|---|---|---|---|
| Return on average equity (ROAE) 1) | 18.2 | 22.8 | (4.6) |
| Return on average assets (ROAA) 2) | 1.42 | 1.63 | (0.21) |
| Net interest margin 3) | 3.00 | 3.21 | (0.21) |
| Cost / income ratio 4) | 47.1 | 45.9 | 1.2 |
| Credit cost ratio 5) | 0.25 | 0.31 | (0.06) |

| | 31. 12. 2013 (%) | 31. 12. 2012 (%) | Y/Y change (pp) |
|---|---|---|---|
| Loan-to-deposit ratio 6) | 77.0 | 75.2 | 1.8 |
| Capital adequacy ratio 7) | 15.6 | 15.2 | 0.4 |
| Leverage ratio 8) | 5.46 | 4.73 | 0.73 |
| Net stable funding ratio 9) | 135.7 | 133.2 | 2.5 |

1) *ROAE is net profit for the year as a percentage of the five point average of total shareholders' equity calculated based on the period end closing balance and the closing balances of the preceding four quarters.*
2) *ROAA is net profit for the year as a percentage of the five point average of total assets calculated based on the period end closing balance and the closing balances of the preceding four quarters.*
3) *Net interest margin is net interest income as a percentage of total average interest-bearing assets excluding repo-operations (calculated based on the period end closing balance and the closing balances of the preceding four quarters).*
4) *The cost / income ratio represents operating expenses before net provisions as a percentage of operating income.*
5) *The credit cost ratio represents total impairment losses on the granted credit portfolio as a percentage of average outstanding volume of the credit portfolio. For the purposes of this calculation, the credit portfolio includes (i) the outstanding gross amount of the credit portfolio , (ii) contingent liabilities gross (i.e. guarantees and other off-balance sheet commitments), and (iii) nominal value of bonds from Investment portfolio (excl. sovereign bonds). Average outstanding volume is calculated as average of the outstanding balances at the beginning and at the end of the period to which the credit cost ratio relates.*
6) *Loan-to-deposit ratio represents loans and receivables as a percentage of primary deposits. For the purpose of this calculation, the definitions are as follows:*
   a) *loan portfolio: Loans and receivables to other than credit institutions 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);*
   b) *primary deposits: ČSOB group deposits minus pension funds minus repo operations with non-banking financial institutions plus deposits to credit institutions (excl. repo operations with credit institutions). In line with system of internal managerial reporting of liquidity.*
7) *End of period regulatory capital (ratios) does not reflect profit for the current year until shareholder approval of the audited financial statements for the period in the following year.*
8) *Tier 1 capital / non-risk value of assets (According to Basel III)*
9) *Available amount of stable funding (equity and liability which are expected to be reliable sources of funds over a one-year time horizon under extended stress) to stable funding required by an institution based on types of its assets, off-balance sheet exposures and activities pursued (according to Basel III)*

*Note: pp = percentage point*

## Awards

**Major awards announced for the ČSOB group in 2013 included:**

- **The Banker** selected ČSOB as the **Bank of the Year 2013**.
- The ***Hospodarske noviny*** business daily selected ČSOB as the **Bank of the Year 2013**.
- ČSOB Private Banking was named Best private bank in the Czech Republic by **Euromoney**, won the **PWM/The Banker Global Private Banking Award 2013** for the Czech Republic as well as the **Best Private Bank** category of the Bank of the Year contest.
- The US-based magazine **Global Finance** awarded ČSOB as the **Best FX Bank** for **the tenth time in a row**. The prize was also won for 2014.
- ČSOB won the title of **Best bank in the Czech Republic in acquisition finance** in 2013 from ACQ Finance Magazine, claiming the prize **for sixth time**.
- ČSOB was selected the **second best employer above 5,000 employees** in the Czech Republic (overall ranking regardless of industry); ČSOB Pojišťovna ranked eighth.
- In the ***Zlata koruna*** contest, **Patria** took gold in the **best securities broker** category. **ČSOB Leasing** received silver and bronze medals and **Postal Savings Bank** a bronze one.
- **KBC Multi Interest CSOB CZK Medium** won the **category** for **Conservative bond fund of the year** 2013.

**For a full list of awards won by the ČSOB group, please go to www.csob.cz.**

## Innovation Leadership in 2013

**Enhancing the Product Offer:**

- In 2013, ČSOB launched 58 new **investment funds**, 23 of them with capital protection. The average yield of open ČSOB mutual funds was 7.3% in 2013, with seven of them beating the 10% yield threshold.
- **Unit-linked life insurance**, the bancassurance flagship of the ČSOB group, also continued to bring investment opportunities to clients of the ČSOB group. Ten products were launched in 2013.
- For its **corporate clients**, ČSOB successfully launched a special cash service for retailers and logistic companies allowing cash deposits directly at clients' premises. The Financial Markets department launched a free application for smartphones which allows an easy access to current news as well as analyses and forecasts published by ČSOB.
- ČSOB Pojišťovna was the first one to introduce **new accident insurance for drivers** RENTO. ČSOB Pojišťovna also started to offer the Best Doctors product, enabling coverage of worldwide treatment in case of serious diseases.
- In the "low seven" campaign, Hypoteční banka offered clients to **lock in the currently low five year rates for seven years**. In addition, the **Mortgage On-Line was redesigned** to be more client friendly and to support tablets.

**Enhancing Client Comfort:**

- As of January 2013, all ČSOB clients may use their **contactless payment cards** at **Czech Post outlets**.
- Clients can easily **settle their invoices** by reading a **QR code** via the SmartBanking application.
- As of March 2013, **SmartBanking** is newly available also **for Windows 8** (ČSOB was the first Czech bank to offer such service).
- **ČSOB, as the only bank in the Czech Republic, launched Czech POINT on selected Era Financial centers** to enable clients to access official registers.
- ČSOB launched **Era portal, new internet banking**, which enables e.g. administration of personal finance and direct sales of products.
- As of October 2013 **all ČSOB clients can use** their debit and credit **cards at Czech Post outlets**.
- As of November 2013 ČSOB and Era offered the clients access to **Comfortable Data Box** via electronic banking.

## The Board of Directors' Assessment of 2013 and Expectations for 2014

In 2013, the entire **Czech banking sector** continued to grow with both loans and deposits increasing, according to CNB data show. Levels of NPLs and credit costs remained benign, notwithstanding the decrease of the Czech Republic's real GDP by 0.9% year on year. Especially the market for company loans and mortgages expanded significantly.

**The year of 2013 was successful for the ČSOB group** which had met its 2013 business plans as a result of the trends detailed below. ČSOB builds on good relations with its clients. ČSOB offers a unique combination of trustworthiness, one of the widest product portfolios, professional advice and unparalleled distribution reach. The ČSOB group saw **growth of deposits as well as loans**, the former in all client segments and the latter especially in mortgages and the corporate segment. The **assets under management** increased by 12% in 2013 (or 5% if adjusted for the acquisition of ČSOB Asset Management Slovakia), comprising capital protected and open mutual funds as well as other asset management.

While the loan portfolio expanded in 2013, **credit costs** were on the decrease and remained below what the Board of Directors believes to be the through-the-cycle level. **The credit cost ratio** contracted to 25 bps in comparison with 31 bps for 2012 as the credit costs decreased or remained flat across all client segments.

**The NPL (non-performing loans) ratio** decreased by 45 bps year on year to 3.12%, positively influenced by the growth of loans as well as decreasing NPLs. The ratio is defined as the ratio of uncertain (non-performing) and irrecoverable loans to credit portfolio and is in line with KBC's methodology.

**The provision coverage of NPLs** is prudent at 75.5%. Mortgages and building savings loans, representing 52% of the group's loan portfolio, require less provisioning because they are largely secured by collateral. The NPLs from the remaining part of the portfolio are covered by allowances, i.e. showing a coverage ratio close to 100%.

The ČSOB group is an integrated part of Czech economy and committed to the market in good times and bad. The ČSOB group will remain a **responsible lender** and continue to extend loans to clients. **ČSOB's main aim** is to better serve the needs of its existing clients and capture the right market share in selected parts of the market, inter alia by expansion of its client base. ČSOB works continuously to make an attractive value proposition for its clients.

The ČSOB group will endeavor to maintain high **profitability** while focusing on asset quality. The strong **capital** and **liquidity** positions of the ČSOB group allow it to grow the loan portfolio faster than its deposits without abandoning its independence of market funding. The Board of Directors does not believe that the low level of **credit costs** in 2013 will be sustained in the coming years.

## Strategy of the ČSOB Group and its Business Model

The ČSOB group is one of the three large financial services groups in the Czech Republic. It is among the top three players in virtually all banking products and is the market leader in mortgages, building savings and asset management. The ČSOB group operates under multiple brands and distribution channels.

The ČSOB group operates a portfolio of businesses that have a different stage of maturity and market position. The portfolio is reviewed regularly, comparing relative performance of individual businesses, and resources are allocated accordingly.

**The ČSOB group has the ambition to deliver strong and sustainable performance.** To reach this goal, the management continuously evaluates the strategic choices and manages the ČSOB group's business portfolio. Key resources (human capital, equity, liquidity and ICT create capacity) are allocated to areas of the **best fit with this ambition. Servicing the retail and SME segments is core to the business of the ČSOB group.** In addition, the ČSOB group manages for value its **corporate banking services**.

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 to get closer to its clients and to make its operating model more effective and efficient; and (iii) builds capabilities which its management believes are critical for future success.

The strategy of the ČSOB group, its new business model and improving capabilities are in line with KBC group philosophy symbolically called PEARL. They are aligned with the KBC group's aim to become the reference in bancassurance in its core markets. The Business Unit Czech Republic has a direct representation at the KBC Group Executive Committee and stands at par to the Belgium and International Markets business units.

# Financial Results

*All financial figures hereinafter were drawn from ČSOB's 2013 audited, consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU IFRS), unless otherwise stated.*

## Consolidated Statement of Income

| | 2013 (CZKm) | 2012 (CZKm) | Y/Y change (%) |
|---|---|---|---|
| Interest income | 30,229 | 32,697 | (7.5) |
| Interest expense | (6,164) | (7,727) | (20.2) |
| **Net interest income** | **24,065** | **24,970** | **(3.6)** |
| Fee and commission income | 9,121 | 8,747 | 4.3 |
| Fee and commission expense | (3,138) | (3,242) | (3.2) |
| **Net fee and commission income** | **5,983** | **5,505** | **8.7** |
| Dividend income | 10 | 26 | (61.5) |
| Net gains from financial instruments at fair value through profit or loss | 2,046 | 2,315 | (11.6) |
| Net realized gains on available-for-sale financial assets | 408 | 126 | 223.8 |
| Other net income | 485 | 2,073 | (76.6) |
| **Operating income** | **32,997** | **35,015** | **(5.8)** |
| Staff expenses | (7,030) | (7,222) | (2.7) |
| General administrative expenses | (7,669) | (8,009) | (4.2) |
| Depreciation and amortization | (832) | (856) | (2.8) |
| **Operating expenses** | **(15,531)** | **(16,087)** | **(3.5)** |
| Impairment losses | (1,447) | (1,584) | (8.6) |
| *In which Impairment on loans and receivables* | (1,378) | (1,631) | (15.5) |
| Share of profit of associates | 52 | 195 | (73.3) |
| **Profit before tax** | **16,071** | **17,539** | **(8.4)** |
| Income tax expense | (2,420) | (2,258) | 7.2 |
| **Profit for the year** | **13,651** | **15,281** | **(10.7)** |
| Attributable to: | | | |
| Owners of the parent | 13,658 | 15,291 | (10.7) |
| Non- controlling interests | (7) | (10) | (30.0) |

## Discussion of the Statement of Income Main Items

With a 73% share, the **net interest income** (NII) was the largest part of the operating income. The ČSOB group generated 3.6% lower NII in 2013 compared to 2012, driven primarily by decreases in most categories on the revenue side which were not fully offset by decreases in key categories on the expense side. The net interest margin decreased from 3.21% in 2012 to 3.00% in 2013 due to the generally low interest rates in the economy and the strong volume growth in corporate loans, where the margins are typically lower than in retail. Excluding the one-off adjustment of mortgage commission accruals in 4Q 2013, net interest margin would reach 3.03% in 2013.

Out of the reporting segments, the highest contribution came from the Retail / SME segment which represents 47% of the consolidated NII; the NII in this segment decreased 2.5% year on year. The bank corporate segment, making up 12% of the consolidated NII, grew 4.4% year on year thanks to higher volumes and resilient margins. Financial markets decreased its NII by 16.8%, the specialized banking segment, which accounts for 28% of the consolidated NII, reported a 3% year on year decline and Group Center decreased by 13.1% year on year.

The **net fee and commission income** (NFCI) represented 18% of operating income. In 2013, NFCI increased by 8.7% vs. 2012 as the income increased by 4.3% and the expense declined by 3.2%. The year-on-year increase stemmed mainly from the higher demand for mutual funds and higher sales in the financial markets area, partly offset by higher commissions paid to distribution. The result was also affected by low comparison basis in 2012, when ČSOB wrote-off deferred acquisition costs in the pension fund.

**Other net income** decreased significantly year on year due to the positive impact of the sale of a stake in ČSOB Pojišťovna in 2012 (CZK 1,230 m).

**Staff expenses** represented 45% of the ČSOB group's operating expenses in 2013. The item includes wages and salaries, variable compensation and social security charges. The largest part (71%) were wages and salaries which decreased by 2% year on year thanks to a lower average number of employees which more than offset the annual wage adjustment. Please note that the 2012 figure included a severance payments reserve related to the 6% headcount reduction during first half of 2013.

**General administrative expenses** (GAE) represented 49% of the ČSOB group's operating expenses in 2013. The item includes IT rental and IT operating expenses, marketing, deposit insurance premium, contribution to the Securities Traders Guarantee Fund and other miscellaneous expenses. GAE declined by 4.2% year on year to CZK 7.7 bn largely due to a decrease in marketing expenses and expenses related to payment cards and electronic banking.

IT-related expenses represent the largest part of GAE (38%). This item showed an increase of 0.7% year on year. Other major items of GAE showed various development in 2013: buildings-related expenses decreased (14% of GAE; -0.8% year on year), deposit insurance grew approximately in line with group deposits (11% of GAE; +3.0% year on year) and marketing expenses dropped (9% of GAE; -13.5% 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 significantly by 8.6% year on year.

This decline was a result of a decrease in impairments on loans and receivables (by 13.7%) and impairment on goodwill (by 100%). The former was due to release of an impairment related to a historical file. The latter was impacted by the impairment of goodwill in ČSOB PF Stabilita in 2012 which was mainly due to legislation changes.

As a result of the above trends, the profit for the year 2013 attributable to owners of the parent was CZK 13,658 m, i.e. 10.7% lower compared to the figure for 2012. Adjusted for the sale of stake in ČSOB Pojišťovna in 2012, the profit attributable to owners of the parent declined by 2.9% year on year.

## Consolidated Statement of Financial Position

*(Condensed)*

| | 2013 (CZKm) | 2012 (CZKm) | Y/Y change (%) |
|---|---|---|---|
| Financial assets held for trading | 204,729 | 162,265 | 26.2 |
| Available-for-sale financial assets | 83,340 | 91,904 | (9.3) |
| Held-to-maturity investments | 150,944 | 138,437 | 9.0 |
| Financial assets at fair value through profit or loss | 7,467 | 7,352 | 1.6 |
| Loans and receivables | 509,256 | 479,516 | 6.2 |
| **Total assets** | **1,034,830** | **937,174** | **10.4** |
| Financial liabilities held for trading | 186,920 | 133,587 | 39.9 |
| Deposits received from other than credit institutions* | 660,342 | 629,622 | 4.9 |
| **Total liabilities** | **954,377** | **863,033** | **10.6** |
| Total equity | 80,453 | 74,141 | 8.5 |
| **Total liabilities and equity** | **1,034,830** | **937,174** | **10.4** |

** Elsewhere in this report referred to as "group deposits".*

## Discussion of the Statement of Financial Position Items

The total consolidated assets of the ČSOB group increased by 10.4% year on year. Loans and receivables, the largest item thereof with a 49% share, increased by 6.2% year on year. Loans and receivables are discussed in detail in the Business Results section below.

The development of securities portfolios (43% of total assets in aggregate) was varied in 2013:

- Financial assets held for trading comprised 20% of total assets and grew 26.2% year on year due to reverse repo operations with the Czech National Bank.
- Held-to-maturity investments (HTM; 15% of total assets) increased by 9.0% year on year.
- Available-for-sale financial assets (AFS; 8% of total assets) declined 9.3% year on year, due to a reclassification of assets from AFS to HTM.
- Financial assets at fair value through profit or loss (1% of total assets) increased slightly by 1.6% year on year.

Further discussion of the portfolios can be found in the 2013 Consolidated Financial Statements, 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 2013 and 2012.

## 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. In order to maintain the capital structure, ČSOB may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

The ČSOB group analyzed the latest proposals of the Basel III regulation and incorporated major changes and ratios into regular management of the risk and capital positions.

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

| (CZKm, unless indicated otherwise) | 2013 | 2012 | Y/Y change (%) |
|---|---|---|---|
| Tier 1 capital = Core Tier 1 capital | 55,245 | 44,975 | 22.8 |
| Tier 2 capital | 76 | 7,983 | (99.0) |
| Deductible items of Tier 1 and Tier 2 | (16) | (788) | (98.0) |
| **Total capital** | **55,305** | **52,170** | **6.0** |
| Capital requirement on credit and settlement risk | 22,475 | 21,669 | 3.7 |
| Capital requirement on market risk | 1,410 | 1,204 | 17.2 |
| Capital requirement on operational risk | 4,524 | 4,516 | 0.2 |
| **Total capital requirement** | **28,409** | **27,389** | **3.7** |
| Risk weighted assets | 355,114 | 342,360 | 3.7 |
| Tier 1 ratio = Core Tier 1 ratio (in %) | 15.6 | 13.0 | 2.6pp |
| Capital adequacy ratio (in %) | 15.6 | 15.2 | 0.4pp |

*Calculation is based on ČNB rules.*

End of period regulatory capital (and the respective ratios) does not reflect retained earnings until the shareholder's approval of the audited financial statements in the following year.

## Credit Rating

In this section, the Board of Directors discusses events related to ČSOB's credit ratings between 1 January 2013 and the date of this Annual Report. ČSOB uses the services of two rating agencies, Fitch Ratings ("Fitch") and Moody's Investor Service Ltd ("Moody's"). Both rating agencies were registered according to Regulation (EC) No 1060/2009 on credit rating agencies of 16 September 2009. No bond issued by ČSOB had a credit rating assigned.

**Moody's** confirmed the ratings and outlook (A2 with a negative outlook) for ČSOB in January and September 2013. Also in September 2013, Moody's published their Banking System Outlook which was negative, based on weak Czech economy (and its implications on performance of banks) and a low interest rate environment.

On 5 December 2013, Moody's improved the outlook on ČSOB's rating from negative to stable. This is a result of the operating environment stabilizing in late 2013 and expectations for the economy to return to growth in 2014.

The **Fitch** rating agency affirmed its rating of ČSOB on 1 October 2013 at BBB+ with a stable outlook.

# Business Results

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

The ČSOB group's business and results of operations 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 have been or will be the principal drivers for the development of the ČSOB group's business and thus its results of operations and financial condition.

1. The global financial crisis led to a global economic downturn and a deterioration of economies in the EU, including the Czech Republic. The most important include:
    - **Real GDP growth** in the Czech Republic may have a positive impact on the ČSOB group; the impact is most notable in the SME and corporate sectors.
    - **Increases in the volumes of imports and exports** may have a positive impact on the ČSOB group.
    - An increase in **unemployment** may cause an increase in loan losses and thus have a negative impact on the ČSOB group.
    - An excessive increase in the **government budget deficit** could lead to a future decrease in government spending, which may have a negative 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 the CNB's repo rates at historical lows, the net interest margin continues to be under pressure.

3. A deterioration of **credit quality** of loans and receivables, both on-balance sheet and off-balance sheet, a decrease in recovery ratios or a deterioration in the value of available collateral would result in an increase in required provisioning ratios.

4. ČSOB holds significant amounts in **securities portfolio** which may have to be revalued or impaired, e.g. due to a lack of liquidity, increase in volatility, the absence of reliable pricing information, adverse changes in the business climate, credit rating downgrades, adverse regulatory actions or unanticipated changes in the competitive environment. This also applies to any sovereign bonds held; for details please refer to Note 40 to the Consolidated Financial Statements.

5. ČSOB, as any bank, is influenced by the **regulatory environment** in force and in making. ČSOB uses major ratios under Basel III to manage risk and capital. The pension and building savings systems are presently undergoing significant changes which may affect both volumes and earnings in the two areas.

6. **Competition:** 44 banks had a banking license as of the 2013 year end. In addition, the EU legislation allows banks from other EU member states to easily enter the Czech banking market, thus further intensifying the competitive environment.

## ČSOB Group Market Position

**1**

| | | |
|---|---|---|
| Building Savings Loans [1] | 45.3% | ↗ |
| Building Savings Deposits [1] | 35.7% | → |
| Mortgages [1] | 30.0% | ↘ |
| Mutual Funds [1] | 28.1% | ↘ |
| Leasing [2] | 13.4% | ↗ |

**2**

| | | |
|---|---|---|
| Total Loans [1] | 19.2% | → |
| Total Deposits [1] | 19.6% | ↘ |
| Factoring [2] | 20.1% | ↘ |

**3**

| | | |
|---|---|---|
| Pension Funds [3] | 14.0% | ↘ |
| Corporate/SME Loans [1] | 14.3% | → |
| Consumer lending [1), 4)] | 11.2% | ↗ |

| Insurance | Market share | | Rank |
|---|---|---|---|
| Life [2] | 6.4% | ↘ | 5 |
| Non-life [2] | 6.5% | ↗ | 6 |
| Total [2] | 6.5% | ↗ | 5 |

*Arrows show year on year change. Market shares as at 31 December 2013.*

*1) Outstanding at the given date.*
*2) New business in the year; for insurance gross written premium.*
*3) Number of clients at the given date.*
*4) Retail loans excluding mortgages and building savings loans.*

## ČSOB Retail / SME

The ČSOB Retail / SME segment **represents 8.9% of ČSOB's assets and 47.6% of ČSOB's liabilities**.

The segment focuses on deposits, consumer loans, overdrafts, credit cards facilities, funds transfer facilities and other transactions and balances with retail and SME customers. Retail customers comprise private individuals and entrepreneurs. The former include affluent (with financial assets up to CZK 10 m) and private banking clients (above CZK 10 m), as well as all categories of mass customers targeted primarily through PSB. SME customers include small and medium-sized enterprises with an annual turnover of up to CZK 300 m, housing cooperatives and municipalities.

### Most Notable Events and Trends in the Segment:

- ČSOB managed to increase volume of **consumer finance** despite a stagnating market.
- SME volumes **ended up 4%** above the 2012 year end level. This led to an **increase** of the ČSOB group's **market share**.

**ČSOB updated its business model and made following changes in the management structure from 1 January 2013:**

- Marek Ditz, the former head of Corporate & institutional banking, became a new member of ČSOB's Board of Directors managing the newly created division **Customer Relationships**.
- Based on client preferences, **this division comprises**: (i) ČSOB-branded distribution networks for private banking, affluent banking and SMEs and (ii) the Postal Savings Bank, distributed via Czech Post outlets.
    - Clients served under the ČSOB brand were not served at Czech Post outlets until 2013. As a major enhancement, they have been able to perform cash operations and entering cashless payments at Czech Post outlets since 2013.
- A specialized **Convenience Services** division was created, managed by the member of the Board of Directors Jan Lamser:
    - It focuses on clients who require convenient services at various places and times through a channel suitable to their needs.
    - The products are offered under the Era brand.

### ČSOB Retail / SME: Key Volumes

| | 2013 (CZKm) | 2012 (CZKm) | Y/Y change (%) |
|---|---|---|---|
| Credit portfolio – consumer loans | 19,142 | 19,129 | 0.1 |
| Credit portfolio – SME | 73,731 | 70,763 | 4.2 |
| *– of which investment loans* | 49,346 | 47,918 | 3.0 |
| *– of which short term loans* | 24,385 | 22,845 | 6.7 |

## ČSOB Corporate

The ČSOB Corporate segment **includes the corporate services of ČSOB** and **made up 11.8% of assets and 11.1% of liabilities of the ČSOB group** as at the 2013 year end.

The ČSOB Corporate segment focuses on providing financial services and products to domestic companies with an annual turnover in excess of CZK 300 m, local subsidiaries of international corporations, and selected institutional customers, including non-banking financial institutions, banks and central public institutions. ČSOB's Corporate segment principally targets mid-cap corporations and seeks to combine local market expertise and products and standards of service customary in developed markets. As at 31 December 2013, the ČSOB group had approximately 4,000 corporate customers in the Czech Republic.

The ČSOB group has a sales network of **11 regional branches** devoted to serving corporate customers, a unique regional coverage among Czech banks. In addition, the ČSOB group also has a specialized branch servicing non-banking financial institutions.

The ČSOB group provides its corporate customers 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 corporate foreign currency and interest rate risks, 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 finance and online trade finance services.

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

### Most Notable Events and Trends in the Segment:

- The volume of the corporate credit portfolio has grown continuously since late 2010 and reached CZK 121.5 bn at the end of 2013 which helped to bring ČSOB's market share to the pre-crisis level; the structure of the credit portfolio further improved.
- ČSOB noticed an increased demand for structured types of financing, e.g. acquisition finance and export finance as well as for plain vanilla loans and credit replacing bonds. Trade finance grew especially thanks to export letters of credit.
- The provision of new loans to the clients was in many cases accompanied by an agreement on the protection of the interest rate exposure, leading to increased sales of the interest rate derivatives.
- Corporate deposits increased in line with the credit growth, mainly thanks to the inflow on the current accounts.

### ČSOB Corporate: Key Volumes

| | 2013 (CZKm) | 2012 (CZKm) | Y/Y change (%) |
|---|---|---|---|
| Corporate loans | 121,531 | 106,536 | 14.1 |

## ČSOB Financial Markets

The ČSOB Financial markets segment **represented 23.1% of ČSOB group's assets and 20.2% of its liabilities** as at the 2013 year end. 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 customer-driven activities for retail, SME, corporate and institutional customers, while trading is a support business for sales activities.

## Specialised Banking

The Specialised banking segment **consists of the result of operations of all ČSOB Bank subsidiaries**. It contains mortgages, building savings, building saving loans, pension funds, leasing, mutual funds, asset management and factoring. The Specialised banking segment started to be reported as a separate segment as from year 2013.

### Most Notable Events and Trends in the Segment:

- Stable real estate prices, interest rates at a record lows and refinancing building savings loans contributed to the 6% growth year on year of mortgage market (measured by total outstanding portfolio). The **ČSOB group's credit portfolio of mortgages increased by 9%** in the same period. The leading position of the ČSOB group was supported by providing CZK 42.0 bn of new mortgages in 2013, the highest amount in the group's history.
- The ČSOB group is therefore the **largest provider of mortgage loans** to individuals in the Czech Republic. All mortgages provided via various distribution channels are booked in Hypoteční banka. During 2013, more than 24,600 mortgages were granted and the average size of a new mortgage was CZK 1.8 m and the interest rate is most frequently fixed for 5 years.
- The portfolio of **building savings loans** decreased year on year as clients in general preferred mortgages to building savings loans in the low interest rate environment. As a result, the whole **market of building savings loans declined by 12% in 2013**. Although its volumes and new sales decreased, ČMSS managed to defend its leading market position in 2013.
- **ČSOB Leasing strengthen its leading position**, outperforming a very competitive market. New sales increased driven by machinery and equipment asset financing.

### Specialised Banking: Key Volumes

| | 2013 (CZKm) | 2012 (CZKm) | Y/Y change (%) |
|---|---|---|---|
| Credit portfolio – mortgages | 199,310 | 183,571 | 8.6 |
| Credit portfolio – building savings loans (55%) | 67,184 | 69,789 | (3.7) |
| Credit portfolio – leasing | 23,461 | 21,820 | 7.5 |
| Credit portfolio – factoring | 4,072 | 3,986 | 2.1 |

## Group Center

The Group Center **comprised 23.5% of ČSOB group's assets and 6.9% of its liabilities** as at the 2013 year end. The segment comprises of the following:

- Interest charge on capital provided to subsidiaries which are a part of the Specialised banking segment.
- The results of the reinvestment of free equity of ČSOB.
- Asset-liability management (ALM).
- Income and expenses not directly attributable to other segments and eliminations.
- Net gains on disposal of participations in ČSOB Pojišťovna and ČSOB AM/IS (only in 2012).

## Insurance

As at 31 December 2013, **ČSOB Pojišťovna** was the fifth largest life insurance company in the Czech Republic with a 6.5% market share in terms of gross written premiums and the sixth largest non-life insurance company in the Czech Republic with a 6.5% market share in terms of gross written premiums (according to the Czech Insurance Association's methodology).

ČSOB Pojišťovna provides its customers with a wide range of insurance products, including single and regular premium life insurance as well as car (for individuals, fleets and leasing business), house, accident, travel and industrial insurance. As at 31 December 2013, ČSOB Pojišťovna had 1.056 thousand customers, comprising of individuals and business entities (including SME's as well as large corporations). Insurance products are mainly distributed through internal agent network, brokers and ČSOB group's branches.

ČSOB Pojišťovna is rated by Standard & Poor's Rating Services. On 10 March 2014, rating of ČSOB Pojišťovna was raised from BBB+ to A- with a stable outlook.

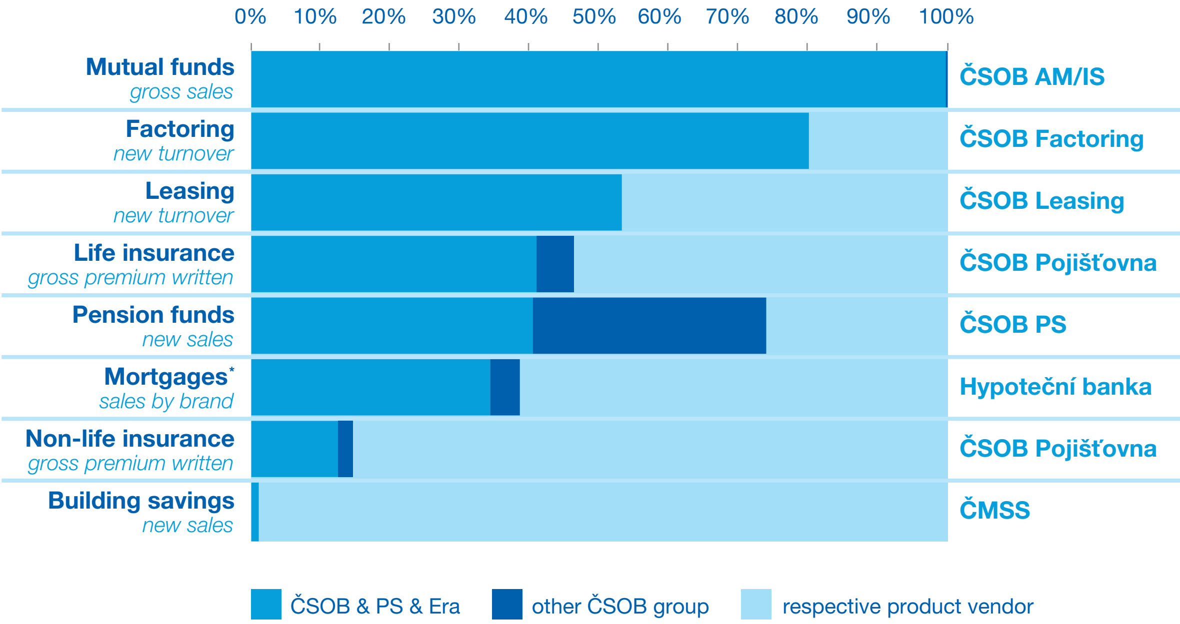
### Insurance: Key Volumes

| | 2013 (CZKm) | 2012 (CZKm) | Y/Y change (%) |
|---|---|---|---|
| Single life insurance | 2,412 | 6,476 | (62.8) |
| Regular life insurance | 2,741 | 2,812 | (2.5) |
| **Life insurance total** | **5,153** | **9,288** | **(44.5)** |
| **Non-life insurance total** | **4,470** | **4,411** | **1.3** |
| **Total** | **9,623** | **13,699** | **(29.8)** |
| Amount of benefits paid to clients | 8,945 | 9,647 | (7.3) |
| Number of cases settled (pcs.) | 214,063 | 208,870 | 2.5 |

## ČSOB Group Synergies

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

### New Production in 2013 – Shares of Distribution Channels per Product Type:




*The chart shows the volumes distributed in 2013 by the companies of the ČSOB group. Distribution by third parties is included in the figures for the respective product vendors (stated in white).*

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

# Company Profile

## ČSOB and ČSOB Group 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 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 remaining interest in the Slovak activities to KBC Bank.

**2013** The establishment of the separate Business Unit Czech Republic within the KBC Group.

### ČSOB

**Československá obchodní banka, a. s.** (ČSOB) 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. ČSOB constitutes the main operating entity of the ČSOB financial group, itself 100% controlled by KBC Group.

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, Era and Poštovní spořitelna (Postal Savings Bank – PSB). Clients are served via ČSOB branches, Era Financial Centers and outlets of the Czech Post network (PSB), where are also distributed products and services of the ČSOB group.

### ČSOB Group

**The ČSOB group** is a leading financial services provider in the Czech Republic. The ČSOB group mainly consists of ČSOB (including Era and PSB), Hypoteční banka, ČMSS, ČSOB Penzijní společnost, ČSOB Leasing and ČSOB Factoring.

Effective 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. In addition to the ČSOB group, Business Unit Czech Republic also includes ČSOB Pojišťovna, ČSOB AM/IS and Patria Finance.

The ČSOB group provides its services to all groups of clients, i.e. retail as well as SME, corporate and institutional clients. The ČSOB group's product portfolio includes:

- financing housing needs (mortgages and building savings loans),
- insurance products,
- pension funds,
- collective investment products and asset management and
- specialized services (leasing and factoring).

With total assets of CZK 1,034.8 bn as at 31 December 2013 and a total net profit of CZK 13.7 bn in 2013, the ČSOB group is one of the top three banking groups in the Czech Republic. As at 31 December 2013, the ČSOB group had CZK 660.3 bn of group deposits and a credit portfolio of CZK 508.5 bn. As of the end of 2013, the ČSOB group employed more than 7,500 employees (FTEs).

## ČSOB Group in Figures

| | 31. 12. 2013 | 31. 12. 2012 |
|---|---|---|
| **Employees** (FTEs) | **7,553** | **7,801** |
| of which the Bank | 6,253 | 6,482 |
| **Clients** (the Bank; in millions)* | **2.9** | **3.0** |
| **Users of internet banking** (the Bank; in millions) | **1.5** | **1.4** |
| **Retail / SME branches and advisory centers** | **556** | **561** |
| ČSOB retail / SME branches | 234 | 238 |
| Era Financial Centers | 74 | 73 |
| ČMSS advisory centers | 136 | 139 |
| Hypoteční banka centers | 26 | 27 |
| ČSOB Pojišťovna branches | 86 | 84 |
| **Leasing branches** | **11** | **13** |
| **ČSOB corporate branches** | **11** | **11** |
| **PSB - outlets of the Czech Post network** | **ca. 3,100** | **ca. 3,200** |
| **ATMs** (the Bank) | **1,006** | **914** |

** The number of ČSOB's clients slightly declined by 1% Y/Y. Note that in 2013, ČSOB has started to use new methodology for client calculation, which further limits existing duplicities.*

*Annual reports and other information about ČSOB and ČSOB group are available at www.csob.cz.*

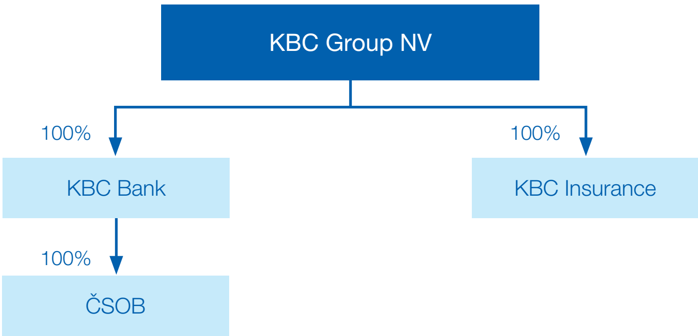
## KBC Group Profile

ČSOB is a wholly-owned subsidiary of KBC Bank NV. KBC Bank is fully owned 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 and Bulgaria. Elsewhere in the world, KBC is present in Ireland and, to a limited extent, in several other countries to support corporate clients in core markets. As of the end of 2013, the KBC Group served approximately 10 million clients in its five home markets and Ireland, and employed approximately 36,000 employees (FTEs; excluding companies to be divested), roughly half of which in Central and Eastern Europe.

For more information please refer to the 2013 Annual Report of KBC Group available on www.kbc.com.

## The simplified scheme of the KBC Group as at 31 December 2013




KBC Group's shares are traded publicly on the Euronext Exchange in Brussels and on the Luxembourg Stock Exchange. KBC Group's core shareholders are: KBC Ancora, Cera, MRBB (a farmers association) and the other core shareholders.

## KBC Group in Figures

| | | 31. 12. 2013 | 31. 12. 2012 |
|---|---|---|---|
| Total assets | EURbn | 241.3 | 256.9 |
| Loans and advances to customers | EURbn | 122.8 | 128.5 |
| Deposits from customers and debt securities | EURbn | 164.1 | 159.6 |
| Net profit, group share | EURm | 1,015 | 612 |
| Tier 1 ratio, group level (Basel II) | % | 15.8 | 13.8 |
| Cost / income ratio, banking | % | 52 | 57 |

For more information please refer to the KBC's corporate website www.kbc.com.

## Long-term Ratings

*(as at 31 December 2013)*

| Long-term ratings | Fitch | Moody's | S & P* |
|---|---|---|---|
| KBC Bank | A- | A3 | A- |
| KBC Insurance | A- | - | A- |
| KBC Group | A- | Baa1 | BBB+ |

**Changes in long-term ratings (since 10 March 2014) - KBC Bank: A, KBC Insurance: A, KBC Group: A-.*

For current long-term ratings and for more information please refer to the KBC's corporate website www.kbc.com.

# ČSOB as a Controlled and Controlling Entity

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

ČSOB is a **controlled entity**. KBC Bank NV (identification number 90029371) is the sole shareholder of ČSOB. KBC Group NV (identification number 90031317) is the sole shareholder of KBC Bank. Both KBC Group and KBC Bank have their registered addresses at: Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek), Belgium.

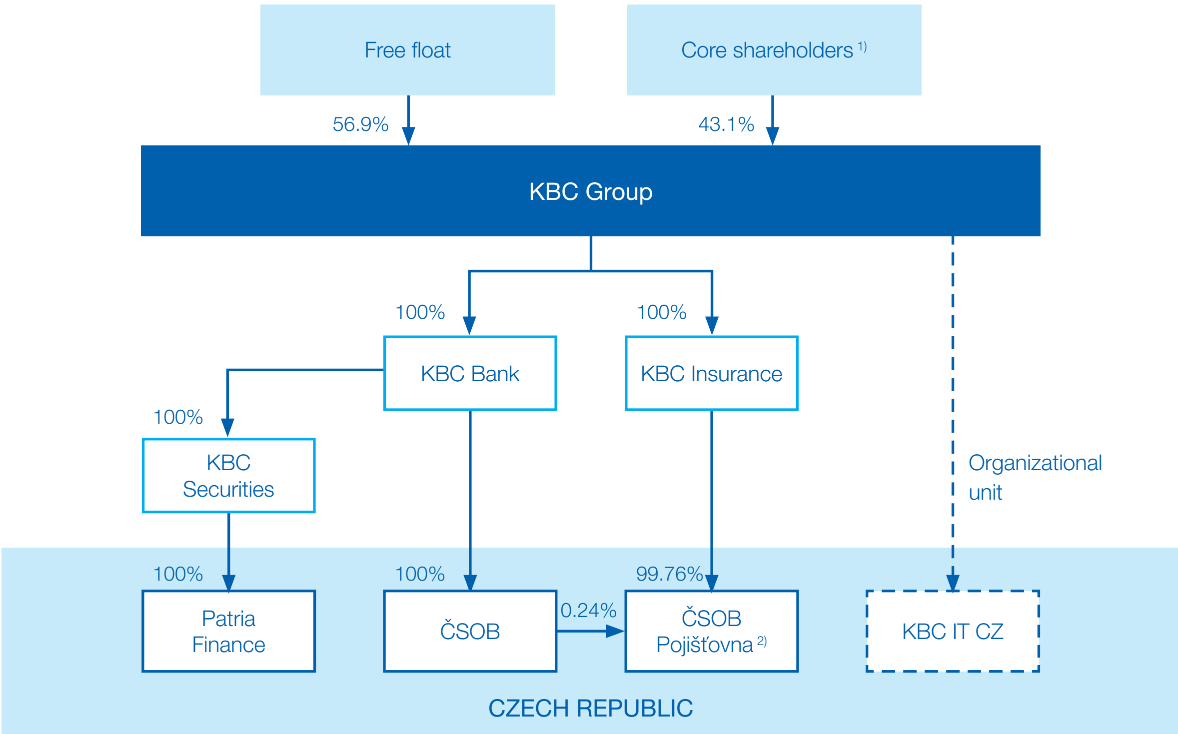
KBC Group and KBC Bank control ČSOB as they dispose with 100% of votes, based on the KBC Bank's ownership interest in ČSOB. ČSOB meticulously follows the legislation applicable on the territory of the Czech Republic to prevent any abuse of this control. ČSOB did not hold any shares of KBC Bank or KBC Group between 1 January and 31 December 2013.

ČSOB is also a **controlling entity**. For information on companies controlled by ČSOB as at 31 December 2013 please refer to the chapter Companies of the ČSOB group.

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

## Main Companies of KBC Group in the Czech Republic

*(as at 31 December 2013)*




*Percentages in the chart denote the ownership interest.*

*1) Main core shareholders are: KBC Ancora, Cera, MRBB (a farmers association) and the other core shareholders.*
*2) Voting rights in ČSOB Pojišťovna are distributed as follows: 40% ČSOB, 60% KBC Insurance.*

For an overview of companies of the KBC group please refer to the KBC's corporate website www.kbc.com.

# Corporate Social Responsibility

## Corporate social responsibility is one of the pillars of ČSOB's corporate philosophy and is an integral part of its business.

Corporate Social Responsibility (CSR) is a natural part of everyday life at ČSOB. In doing business, it honours respect for diversity, freedom of choice, and accountability, and builds on volunteerism and developing the environment in which it operates. These principles are also the foundation of ČSOB's corporate social responsibility priorities: supporting community and the individual engagement and volunteerism of ČSOB employees and the general public.

ČSOB implements its corporate social responsibility strategy through **long-term partnerships with non-profit organisations and through relations with interesting persons and entities**. ČSOB aspires to be an inspiring company whose values are shared by its employees, clients, and suppliers, and also one whose activities reflect an awareness of and adherence to trends in sustainable development.

## Our partner organisations

The longest-standing partner organisation with which ČSOB has cooperated (since 1995) is Výbor dobré vůle – Nadace Olgy Havlové (Committee of Good Will – the Olga Havel Foundation). Since the turn of the millennium, to which point dates the bank's strategic development of corporate social responsibility, ČSOB has been developing other partnerships, such as with Nadace VIA (VIA Foundation), Centrum Paraple (Paraple Centre), Asociace občanských poraden (Association of Citizens' Advisory), Poradna při finanční tísni (Advisory for Financial Distress), Nadace Charty 77 – Konto Bariéry (The Charta 77 Foundation – the Barrier Account), Domov Sue Ryder, Sdružení Neratov (Neratov Association), and Sportovní klub vozíčkářů (Wheelchair Sports Club). For several years, we have also been cooperating with organisations focusing on the development of CSR and philanthropy in the Czech Republic – Fórum dárců (Donors Forum), Byznys pro společnost (Business for Society), and Business Leaders Forum.

## Awards earned in 2013

ČSOB's sustained efforts in corporate social responsibility have earned it numerous awards.

**The Czech PR Award, Internal Communication** category
ČSOB was honoured for its 2012 internal campaign focusing on supporting its employees' participation in the Běh pro dobrou věc (Run for a Good Cause) charitable project, organised alongside the Prague Marathon and half-marathon.

**Bank of the Year 2013, Bank without Barriers** category
Handicapped people from all regions of the country selected ČSOB as the most easily accessible bank for the handicapped. ČSOB earned this award for the third time in a row.

**A Family-Friendly Company of 2013**
ČSOB has undergone an audit of its measures and policies in terms of harmonising professional, personal, and family life, and of cooperation with its employees while they are on maternity or parental leave, etc., earning it certification by the Síť mateřských center (Czech Network of Mother Centers), confirming that it is a family-friendly company.

## ČSOB's key long-term areas of support have been: responsible business, education, diversity, and the environment.

In 2013, ČSOB devoted nearly CZK 49.5 m to corporate social responsibility activities. The funds were expended equally on philanthropic purposes and on social investments.

# Responsible Business

**ČSOB and its employees honour values that reflect ethical conduct and decision-making, transparency in business, and fair partnership with clients and suppliers.**

## Responsible company

A key programme through which ČSOB continues to promote a culture that will not tolerate corruption is the **ČSOB Anti-Corruption Programme**, which has been in place since 1 October 2012. The programme features rules and policies that we follow in aiming to prevent corruption and conflicts of interest.

- ČSOB does not finance transactions concerning weapons, whether their producers, traders, or customers.
- ČSOB supports environmental protection by reflecting "Equator principles" in its activities, i.e., it monitors the environmental impact and social and societal consequences of the activities it finances.
- ČSOB does not finance transactions involving countries that grossly violate human rights.

## Accessibility of our services

- **Wheelchair-accessible branches**

  81% of ČSOB's 314 branches are wheelchair-accessible. Also one-third of more than 3,000 outlets of the Czech Post network where ČSOB products are provided, are wheelchair accessible, and others are equipped with signalling devices to call staff.
- **ATMs with an application for the visually impaired**

  Nearly 75% of all of ČSOB's ATMs have been adapted to the visually impaired, which means that they are equipped with voice navigation.
- **The Era eScribe for the hearing-impaired**

  At all 74 Era Financial Centers, people who are deaf or whose hearing is seriously impaired can communicate with client staff, thanks to the across-the-board introduction of the Era eScribe service.
- **Acoustic orientation beacons for the visually impaired**

  50% of Era's Financial Centers were made accessible for visually impaired people in 2013, thanks to the installation of digital beacons.

## Responsible products

- **Era accounts for seniors, the handicapped, and non-profit organisations**

  In 2013, the Bank kept 278,234 accounts for seniors, 22,307 accounts for the handicapped, and 26,035 accounts for non-profit organisations. All of these accounts are operated with lower fees.
- **Investments into socially responsible funds**

  Since 2000, ČSOB has offered socially responsible investing (referred to as SRI investments). These investments are directed into carefully chosen companies assessed by independent advisory bodies.

## Employee philanthropy and volunteering

- **The Helping Together Grant Programme**

  In 2013, for the sixth time, employees could have applied for a financial contribution for a non-profit organisation in which they help out. The evaluation committee divided CZK 953 ths among 39 projects. Supported projects included the organisation of transport for handicapped children from locales across a region to an educational institution; the creation of an educational video for teachers of children with cystic fybrosis; the purchase of positioning orthopaedic armchairs for a reading room for seniors; and the purchase of equipment for children's summer camps.
- **ČSOB and Era Help Fund**

  Employees can apply for support from the fund for their family and friends who are physically handicapped. The funds are intended for compensatory aids for children as well as adults, personal assistance for handicapped children and students, and education of handicapped children. Over CZK 1,190 ths was distributed in 2013.

- **Sluníčkový den**

  For the twelfth time, ČSOB was a partner of the public collection Sluníčkový den (Sunny Day) for abandoned children and foster families, organised by the Nadační fond Rozum a Cit (Sense and Sensibility Endowment Fund). The proceeds, CZK 470 ths, were processed free of charge by 46 ČSOB branches.

- **Volunteer Days**

  621 ČSOB and ČSOB AM/IS employees participated in the sixth annual Volunteer Programme, which is the greatest number in the programme's history (and 164 volunteers more than in 2012).

- **Run for a Good Cause**

  For the fourth time, ČSOB employees ran for a good cause in the Prague Half-marathon and Marathon. For every kilometre they ran, ČSOB donated CZK 100 to Výbor dobré vůle – Nadace Olgy Havlové. 393 employees participated in the races and ČSOB donated CZK 562 ths for the purchase of compensatory aids for handicapped children and adults.

### Other activities

- Helping Domov Sue Ryder has already become a tradition. In two collections, ČSOB employees donated items for the organisation's Prague charitable shops. In the June flood collection, employees donated CZK 20.9 ths to the organisation, with ČSOB matching the amount.
- For the fourth time, ČSOB employees bought Christmas presents for children from children's homes. They fulfilled wishes for 211 children from children's homes in Dlažkovice, Korkyně, Mašťov, Planá u Mariánských Lázní, Potštejn, Unhošť, and Vrbno pod Pradědem and bought items for shared use in each of the children's homes.
- As usual, ČSOB employees also supported non-profit organisations and sheltered workshops by buying items at Easter, Christmas, and other markets held throughout 2013 at the headquarters building in Prague.
- In 2013, 299 ČSOB employees participated in the fourth annual internal campaign called 'Give Blood, the Gift of Health!' in support of blood, blood component, and bone marrow donations.

## Education

**ČSOB supports education and values all initiatives aimed at increasing the level of education and life-long education of all social groups.**

### Financial literacy

For the seventh year, ČSOB has supported free **Debt Counselling**, provided by the Asociace občanských poraden. In 2013, the Bank contributed CZK 2.3 m to its operation. Its services were used by more than 7,000 clients throughout the Czech Republic in 2013. For just as long, ČSOB has been contributing to the services of **Poradny při finanční tísni**, to which it donated CZK 1,469 ths in 2013. Its free counselling services were used by 11,490 clients in that period.

In the **Education Programme**, which ČSOB has announced annually since 2010, the Bank finances interesting projects aimed at increasing financial literacy. Thus far, ČSOB has given over CZK 4 m in support of 43 projects.

### Education

ČSOB's cooperation with Výbor dobré vůle – Nadace Olgy Havlové, in the **Education Fund**, has thrived for eighteen years. In 2013, a regular scholarship was granted to another 14 students with medical or social handicaps, and to children from children's homes. Overall, the fund supported 67 students in 2013. Since its establishment, the Education Fund has supported 418 students through scholarships that are paid out for one to six years. Over 440 students received a one-time contribution. Overall, the Education Fund expended CZK 23 m in support of medically and socially handicapped students.

In 2013, the Bank also donated CZK 1 m to the Nadační fond České bankovní asociace **Kamarádi vzdělání** (Czech Bank Association Endowment Fund Friends of Education), which supports the development of children.

## Other activities

- ČSOB donated CZK 300 ths in support of the **Férová škola** (Fair School) project, organised by Liga lidských práv (League of Human Rights), focusing on inclusive education for children.
- In 2013, ČSOB contributed CZK 177 ths to beneficial projects of non-profit organisations through **Nadace Divoké husy** (Wild Geese Foundation), the proceeds of which went towards education for various target groups.
- In cooperation with **Prázdninová škola Lipnice** (Lipnice Holiday School) and the children's homes that ČSOB supports, a three-day seminar for young people preparing to leave children's homes took place in September 2013.
- In 2013, ČSOB organised **financial literacy courses** for schools and non-profit organisations, both in Prague and throughout the regions. Branch employees welcomed primary school pupils and children from children's homes, sharing with them basic information from the world of finance and banking. One of the groups trained in financial literacy were blind cafe operators from the Kavárna POTMĚ project of the Nadační fond Českého rozhlasu – Světluška project, which ČSOB supported.

## Social enterprise

In its Social Enterprise Stabilisation grant programme, a committee comprised of the grant programme's partners (P3 – People, Planet, Profit, o.p.s., and Ergotep) and ČSOB employees selected four winners at the end of 2013 (365, o.p.s., Semitam s.r.o., Zelená dílna s.r.o., and o.s. Náruč), who received not only financial assistance but also professional consulting worth a total of CZK 320 ths in 2014.

## Individual donorship

### The Help Grant Programme

ČSOB and Era, together with Nadace VIA, announced the first annual Help grant programme in 2013, whose goal is to develop philanthropy among children and young adults aged 7 to 26 years and reward their creativity. Selected projects of informal groups of children and young people received incentive grants matching all donations collected, up to the amount of CZK 10 ths. Three of the most interesting projects also received a bonus of CZK 50 ths. Over CZK 212 ths were distributed through the programme.

### Klikniadaruj.cz

The modern "Klikni a daruj" payment tool enables non-profit organisations to receive on-line donations from their donors. Through the "Klikni a daruj" payment button that an organisation places on its website, donors can make a payment from their account with ČSOB/Era, by a payment card issued by any bank, or with their PaySec wallet. When making a payment, donors can disclose their personal information to the selected non-profit organisation by checking off a box, making it possible for the organisation to contact them directly, and allowing them to request a confirmation of their donation.

### Modrý život

The Modrý život (Blue Life) portal, whose establishment ČSOB supported, aiming to help people make regular and long-term contributions, presents specific projects organised by non-profit organisations, to which people can donate on-line. The website is linked to Facebook, which means that donors can let their friends share their experience of making a donation, thereby casually motivating them to also give financial help.

ČSOB has long provided support to **Darujsprávně.cz**, a donations portal operated by the non-profit organisation Fórum dárců. Together with this organisation, which focuses on developing philanthropy in the Czech Republic, the bank also organises meetings and workshops pertaining to individual donorship.

# Diversity

**ČSOB supports equal employment opportunities, focuses on creating opportunities for handicapped persons, enables work flexibility, and builds respect for others.**

## Equal opportunities

ČSOB also pays attention to developing women as leaders. Under the name **Zlatá rybka** (Goldfish), regular meetings of female managers take place, focusing on their professional development, management skills, leadership, career plans, and also on combining work and personal lives and focusing on oneself and one's personal and professional development. The initiative also includes coaching.

Equal opportunities also constitute a part of a company-wide Employee Satisfaction Survey. Everyone who works at ČSOB can pursue his or her professional as well as personal development by choosing from the Bank's offer of courses and training, depending on his or her focus and needs.

## Supporting handicapped persons

In 2013, ČSOB launched a long-term campaign entitled **Fandím OZP** (I support the handicapped people) in support of the employment of handicapped persons and of raising the awareness of ČSOB employees about this area. The campaign included a communication campaign, internal workshops for managers, and events for employees, including an exhibition of Robert Vano's photographs.

ČSOB was the main partner of the **Srdcerváči** (Heartbreakers) project of Nadační fond pro podporu zaměstnávání osob se zdravotním postižením (Endowmen Fund for the Support of Disabled People), focused on fundraising and drawing media attention to the topic. The project collected CZK 420 ths through a public collection.

## Combining professional and personal lives

ČSOB helps its employees combine their professional and personal lives, for example, by offering flexible work hours, part-time jobs, and the option to work from home (referred to as home office). The Bank also provides help through its Programme for Mothers and Fathers (employees on parental leave), in which 188 employees are involved.

As of the second half of 2012, thanks to a grant from the European Social Fund for the Work and Family – Equal Opportunities for Parents Working at ČSOB project, the Bank has been paying attention to questions of the work and life balance of its employees, enhancing cooperation between managers and employees, and improving the work integration of employees who are on parental leave.

ČSOB is also beginning to pay attention to age management and activities focused on older employees.

# The Environment

**ČSOB not only meets its statutory obligations, but surpasses them, in mitigating the adverse environmental impact of its business. It focuses on using energy and resources economically and supporting environmentally conscious behaviour among its employees.**

## Environmental responsibility

Since 2012, ČSOB has, in line with the Czech standard ČSN EN 16001, adhered to the undertaking to continuously reduce the energy-intensity of its operations in the Czech Republic. A reduction in electricity consumption is manifest both in terms of savings on electricity costs and in a reduction of the carbon dioxide produced. ČSOB's goal is to purchase 100% of its electricity from renewable resources for all of the bank's buildings and branches. In 2013, that share was 35%.

### Other activities

- ČSOB employs modern technologies that achieve the same output with reduced electricity consumption.
- ČSOB prefers cooperating with suppliers who hold certificates confirming adherence to environmental standards.
- ČSOB employees use lighter-weight office paper and office supplies whose production and liquidation does not burden the environment. They also sort office waste.

### Supporting regional development

The ČSOB and Era programme for supporting ČSOB regions was launched in 2007. In its seven years, the programme has donated nearly CZK 21 m to community projects. All of them are targeted at their immediate communities.

Employees were able to nominate projects from their regions for support from the ČSOB and Era CSR Regional Fund, focused on education, integration, and the employment of handicapped persons. In year two, CZK 421 ths was expended in support of 16 projects.

### Employee activities

ČSOB and its employees alike think and make decisions in a manner that is conscious of the environment and the immediate community. ČSOB employees actively engage in beneficial activities, even in their personal lives.

117 of ČSOB employees participated in the Ride Your Bike to Work campaign, organised in May 2013 by the Auto*Mat civic association. Forming 32 teams from various parts of the country, they rode a total of 26,698 km when commuting to work by bike.

## Our vision for the upcoming period

Knowing that corporate social responsibility and a commitment to sustainable development are long-term undertakings and investments whose results can only be seen after some time, ČSOB will continue to pursue the priorities it had identified as key for its employees, clients, the community in which it operates, non-profit organisations, and other beneficial initiatives. It will also pay attention to developing more socially responsible products and services, aiming to inspire others and contribute to the development of a responsible society.



*For more information, see the ČSOB Group Corporate Social Responsibility Report for 2013 on the www.csob.cz website.*

## ČSOB group

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

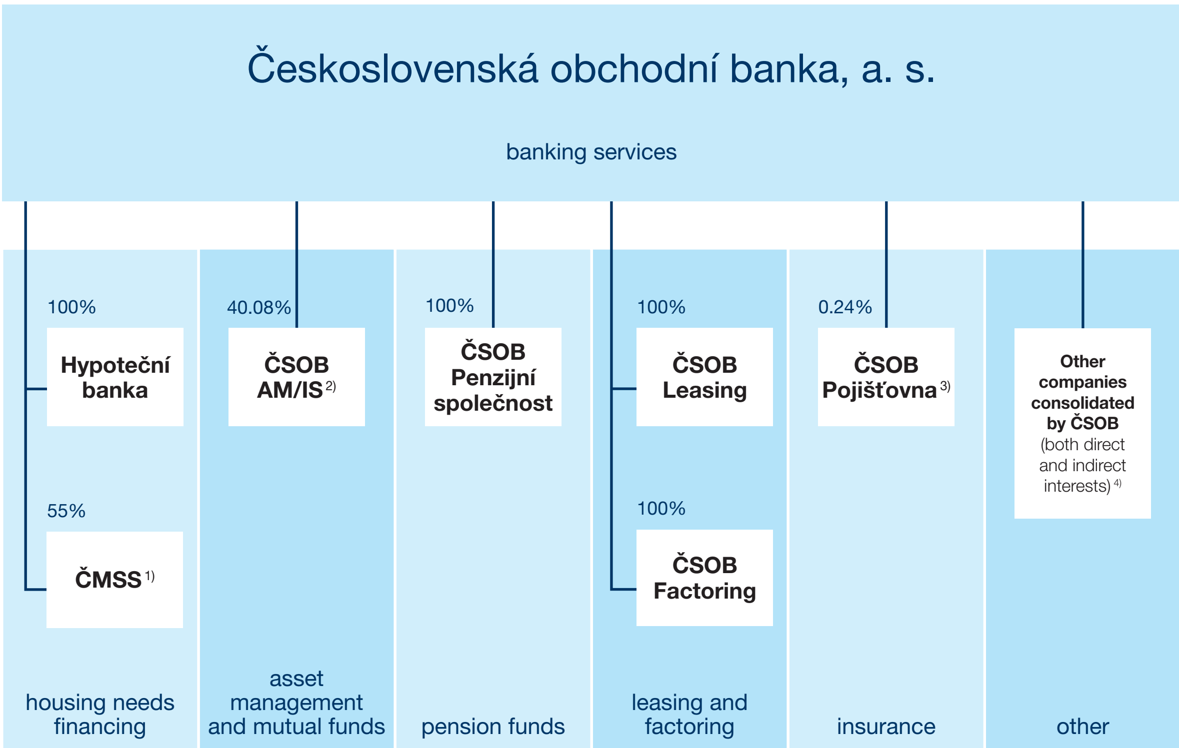
As at 31 December 2013, ČSOB had ownership interests in 29 legal entities and, in addition to ČSOB, other 25 companies were included in the group of consolidated companies.

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

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

## ČSOB's Consolidated Group

*(as at 31 December 2013, EU IFRS)*




*Percentages in the chart denote the ČSOB's ownership interest on company's equity.*
*Percentages in voting rights in companies consolidated by ČSOB are stated in this part of ČSOB Annual Report 2013.*

*1) 45% of shares owned by Bausparkasse Schwäbisch Hall; a proportional consolidated subsidiary of ČSOB.*
*2) 59.92% of shares owned by KBC Participations Renta C; subsidiary consolidated in ČSOB by an equity method.*
*3) 99.76% of shares owned by KBC Insurance; subsidiary 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 2013.*

## Hypoteční banka, a.s.

| | |
|---|---|
| **Date of establishment:** | 10. 1. 1991 |
| **Business activities:** | Provision of mortgage loans and issuance of mortgage bonds |
| **Identification number:** | 13584324 |
| **Registered capital:** | CZK 5,076,334.5 ths* |
| **Shareholders:** | 100% ČSOB |

** Registered capital was increased to CZK 5,076,335 ths on 6 March 2014.*

Contact

| | |
|---|---|
| **Address:** | Radlická 333/150<br>150 57 Praha 5 |
| **Telephone:** | +420 224 116 515 |
| **Fax:** | +420 224 119 722 |
| **E-mail:** | info@hypotecnibanka.cz |
| **Internet:** | www.hypotecnibanka.cz |

Hypoteční banka focuses exclusively on providing mortgage loans. Hypoteční banka has the most extensive portfolio of products and services in the Czech market and offers all possibilities for housing financing, including insurance products.

In 2013, Hypoteční banka provided about 25,500 mortgage loans with a total volume of CZK 43 bn and maintained its position as the leader in the market for new mortgage loans with a market share of 28%.

| Indicator* | | 2013 | 2012 |
|---|---|---|---|
| Total assets | CZKm | 213,948 | 201,176 |
| Loans and advances to customers | CZKm | 196,097 | 180,677 |
| Total equity | CZKm | 27,918 | 27,856 |
| Profit for the year after tax | CZKm | 2,858 | 2,795 |
| ** EU IFRS, audited.* | | | |
| Branches | | 26 | 27 |
| Agents and brokers | ca. | 3,700 | 3,200 |

## 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

| | |
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| **Address:** | Vinohradská 3218/169<br>100 17 Praha 10 |
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| **E-mail:** | info@cmss.cz |
| **Internet:** | www.cmss.cz |

In the long run, ČMSS has been the best performing building savings society and the most popular provider of housing loans on the Czech market.

With 61.3%, ČMSS achieved the highest market share ever in total housing loans in 2013. ČMSS has provided over 955,000 loans totaling CZK 319 bn since it entered the market in 1993.

| Indicator* | | 2013 | 2012 |
|---|---|---|---|
| Total assets | CZKm | 165,585 | 168,650 |
| Volume of loans and bridging hans (Retail) | CZKm | 119,888 | 124,781 |
| Volume of client deposits | CZKm | 153,830 | 156,462 |
| Total equity | CZKm | 9,969 | 10,449 |
| Profit for the year after tax | CZKm | 1,400 | 1,835 |
| ** EU IFRS, audited.* | | | |
| Advisory centers | | 136 | 140 |
| Tied agents | ca. | 2,110 | 2,300 |

# 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 |

Asset Management

Contact

| | |
|---|---|
| **Address:** | Radlická 333/150<br>150 57 Praha 5 |
| **Telephone:** | +420 224 116 702 |
| **Fax:** | +420 224 119 548 |
| **E-mail:** | csobam@csob.cz |
| **Internet:** | www.csobam.cz |

ČSOB AM/IS 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/IS also participates in product development for the entire ČSOB group.

ČSOB AM/IS also manages the assets of several foreign funds within the KBC group.

Customers of ČSOB AM/IS include insurance companies, pension funds, municipalities, trading, production and energy companies, trade unions, foundations and other non-profit organizations, as well as private individuals.

ČSOB AM/IS offers the services to clients via ČSOB branches, outlets of the Czech Post network and Era Financial Centers.

| Indicator | | 2013 | 2012 |
|---|---|---|---|
| Total assets managed by ČSOB AM/IS [1] | CZKm | 162,520 | 145,194 |
| Total assets in funds distributed by CSOB Group [1], [2] | CZKm | 76,107 | 69,050 |

*1) According to methodology of Czech Capital Market Association (AKAT); total statistic including funds and asset management.*
*2) Local and foreign funds distributed by ČSOB group.*

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

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

** Date of establishment of ČSOB PF Stabilita.*

ČSOB Penzijní společnost

Contact

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| **Telephone:** | +420 495 800 600 |
| **Fax:** | +420 224 119 536 |
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| **Internet:** | www.csob-penze.cz |

ČSOB Penzijní společnost was incorporated on 1 January 2013 through the transformation of ČSOB PF Stabilita. It provides pension insurance through the transformed fund and (since 1 January 2013) offers pension savings through pension funds and supplementary pension savings through various participations funds with different investment strategy.

All of the above pension savings products are supported by the Czech state in various forms.

The pension savings products are distributed through the ČSOB group, mostly by ČSOB bank and ČMSS agents.

| Indicator | | 2013 | 2012 |
|---|---|---|---|
| Funds registered in favour of participants of the transformed fund Stabilita | CZKm | 32,471 | 28,855 |
| – of which contributions of participants | CZKm | 25,717 | 22,795 |
| Participant funds in pension funds | CZKm | 20 | 0 |
| Participant funds in participation funds | CZKm | 116 | 0 |
| Profit for the year after tax* | CZKm | -30 | 110 |

** EU IFRS, unaudited.*

| | | | |
|---|---|---|---|
| Customers | ca. | 697,000 | 732,000 |

## 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:** | | |
| *% of registered capital* | 100% | ČSOB |
| *% of voting rights* | 50.82% | ČSOB |
| | 49.18% | KBC Lease Holding |

ČSOB Leasing

Contact

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| **Telephone:** | +420 222 012 111 |
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| **E-mail:** | info@csobleasing.cz |
| **Internet:** | www.csobleasing.cz |

ČSOB Leasing provides financing of cars, trucks, machinery and equipment and technologies (incl. big ticket financing). ČSOB Leasing provides customers with a wide range of financial products for financing of productive assets.

ČSOB Leasing has been awarded many awards in the Zlatá koruna contest for the best financial products in the category of Leasing for Entrepreneurs.

ČSOB Leasing is a holder of ISO 9001:2008 certificate of quality.

| Indicator | | 2013 | 2012 |
|---|---|---|---|
| Volume of new leasing business | CZKm | 13,273 | 11,616 |
| Total assets* | CZKm | 24,999 | 22,976 |
| Profit for the year after tax* | CZKm | 453 | 467 |

** EU IFRS, unaudited.*

| | | |
|---|---|---|
| Branches | 11 | 13 |

## 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 |

ČSOB Factoring

Contact

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| **E-mail:** | info@csobfactoring.cz |
| **Internet:** | www.csobfactoring.cz |

ČSOB Factoring has been providing factoring services to its clients more than twenty years. Thanks to the quality of service maintained on a long term, basis its market share is above 20%. In 2013, the volume of receivables assigned to ČSOB Factoring reached CZK 29.3 bn and remained practically on the same level as in the previous period. Out of that, the company supplies to ČSOB a significant amount of services in the field of receivables management.

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

| Indicator | | 2013 | 2012 |
|---|---|---|---|
| Turnover of receivables | CZKm | 29,247 | 29,489 |
| Total assets* | CZKm | 3,825 | 3,725 |
| Profit for the year after tax* | CZKm | 75 | 75 |

** EU IFRS, unaudited.*

## 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:** | | |
| *% of registered capital* | 99.76% | KBC Insurance |
| | 0.24% | ČSOB |
| *% of voting rights* | 60% | KBC Insurance |
| | 40% | ČSOB |

ČSOB Pojišťovna

Contact

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| **E-mail:** | info@csobpoj.cz |
| **Internet:** | www.csobpoj.cz |

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 2013, ČSOB Pojišťovna posted a net profit of CZK 635 m mainly thanks to good business results. Gross written premium reached CZK 9.6 bn.

| Indicator* | | 2013 | 2012 |
|---|---|---|---|
| Gross written premium life insurance | CZKm | 5,153 | 9,288 |
| Gross written premium non-life insurance | CZKm | 4,470 | 4,411 |
| Profit for the year after tax | CZKm | 635 | 620 |

** EU IFRS, audited.*

| | | | |
|---|---|---|---|
| Branches | | 86 | 84 |
| Customers, comprising individuals and business entities, including small and medium-sized businesses, as well as large corporations. | cca | 1,056,000 | 1,039,000 |

# Companies of the ČSOB Group

*(as at 31 December 2013)*

| Legal Entity: ID No. | Business Name of Legal Entity / Business Activities | Registered Office | Registered Capital (CZK) | Share of ČSOB in: Registered Capital – Total (%) | Registered Capital – Direct (%) | Registered Capital – Indirect (%) | Voting Rights (%) | Indirect Share of ČSOB via | Cons. EU IFRS [1] (Y/N) |
|---|---|---|---|---|---|---|---|---|---|
| **Controlled Companies** | | | | | | | | | |
| 63987686 | **Bankovní informační technologie, s.r.o.**<br>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 | **Centrum Radlická a.s.**<br>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 | **ČSOB Advisory, a.s.**<br>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 | **ČSOB Factoring, a.s.**<br>Factoring | Praha 10, Benešovská 2538/40 | 70,800,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 63998980 | **ČSOB Leasing, a.s.** [3]<br>Leasing | Praha 4, Na Pankráci 310/60 | 3,050,000,000 | 100.00 | 100.00 | none | 50.82 | none | Y |
| 27151221 | **ČSOB Leasing pojišťovací makléř, s.r.o.**<br>Insurance broker | Praha 4, Na Pankráci 60/310 | 2,000,000 | 100.00 | none | 100.00 | 100.00 | ČSOB Leasing | Y |
| 61859265 | **ČSOB Penzijní společnost, a. s., a member of the ČSOB group**<br>Pension insurance | Praha 5, Radlická 333/150 | 300,000,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 27924068 | **ČSOB Property fund, closed-ended investment fund, a.s., a member of the ČSOB group** [4]<br>Collective investment | Praha 5, Radlická 333/150 | 878,000,000 | 61.61 | 59.79 | 1.82 | 95.67 | ČSOB AM/IS, ČSOB Pojišťovna | Y |
| 61251950 | **Eurincasso, s.r.o.**<br>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 | **Hypoteční banka, a.s.**<br>Mortgage banking | Praha 5, Radlická 333/150 | 5,076,334,500 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 25617184 | **Merrion Properties s.r.o.**<br>Real estate activity; rent of flats and non-residential spaces | Praha 5, Radlická 333/150 | 6,570,000 | 61.61 | none | 61.61 | 95.67 | ČSOB Property fund | Y |
| 00000949 | **MOTOKOV a.s. in liquidation**<br>Wholesale of machines and technical equipment | Praha 8, Thámova 181/20 | 62,000,000 | 70.09 | 0.50 | 69.59 | 70.09 | ČSOB Advisory | Y |
| 36859516 | **Property LM, s.r.o. in liquidation**<br>Real estate activity; rent of flats and non-residential spaces | Bratislava, Medená 22/98, Slovak Republic | 137,000 | 61.61 | none | 61.61 | 95.67 | ČSOB Property fund | Y |
| 36859541 | **Property Skalica, s.r.o.**<br>Real estate activity; rent of flats and non-residential spaces | Bratislava, Medená 22/98, Slovak Republic | 51,120,000 | 61.61 | none | 61.61 | 95.67 | ČSOB Property fund | Y |
| 02451221 | **Radlice Rozvojová, a.s.**<br>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 [2] | **TEE SQUARE LIMITED, Ltd.**<br>Advisory services for investment funds in the Caribbean area | British Virgin Islands, Tortola, Road Town, Third Floor, The Geneva Place, P.O.Box 986 | 8,158,609 | 100.00 | 100.00 | none | 100.00 | none | Y |

| Legal Entity | | | | Share of ČSOB in: | | | | Indirect Share of ČSOB via | Cons. EU IFRS [1] |
|---|---|---|---|---|---|---|---|---|---|
| ID No. | Business Name of Legal Entity / Business Activities | Registered Office | Registered Capital | Registered Capital | | | Voting Rights | | |
| | | | | Total | Direct | Indirect | | | |
| | | | CZK | % | % | % | % | | Y/N |
| **Joint Venture** | | | | | | | | | |
| 49241397 | **Českomoravská stavební spořitelna, a.s.**<br>Building savings bank | Praha 10, Vinohradská 3218/169 | 1,500,000,000 | 55.00 | 55.00 | none | 55.00 | none | Y |
| **Others** | | | | | | | | | |
| 26199696 | **CBCB - Czech Banking Credit Bureau, a.s.**<br>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 |
| 26760401 | **COFELY REN s.r.o.**<br>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** [5]<br>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** [6]<br>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**<br>Insurance brokerage | Pardubice, Zelené předměstí, Masarykovo náměstí 1458 | 400,000 | 0.24 | none | 0.24 | 40.00 | ČSOB Pojišťovna | Y |
| 45316619 | **IP Exit, a.s.** [7]<br>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.**<br>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.**<br>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 |

*1) A list of entities belonging to the ČSOB consolidated group according to EU IFRS as at 31 December 2013.*
*2) ID No. 99999999 – a foreign entity.*
*3) Shares in voting rights: ČSOB 50.82%, KBC Lease Holding 49.18%.*
*4) Shares in registered capital: ČSOB 59.79%, ČSOB AM/IS 4.33%, ČSOB Pojišťovna 35.88%; shares in voting rights: ČSOB 95.67%, ČSOB AM/IS 4.33%.*
*5) 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%.*
*6) Shares in registered capital: ČSOB 0.24%, KBC Insurance 99.76%; shares in voting rights: ČSOB 40%, KBC Insurance 60%.*
*7) 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%.*

*E.T.I., a.s. in liquidation (ID No.: 60736682; shares in registered capital and shares in voting rights: ČSOB 10%) – erased of an entry in the Register of Companies on 20 September 2013.*

**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, ČSOB's ultimate owner, is extensively exploited. ČSOB professes principles formulated in the Code of Governance and seeks to observe them consistently in its day-to-day activities. The Code of Governance is available for inspection in the ČSOB's Corporate Office.**

# Managing and Supervisory Bodies

ČSOB has a two-tier board system consisting of a **Board of Directors** and a **Supervisory Board**. The Board of Directors represents ČSOB in all matters and is assigned its management, while the Supervisory Board oversees the Board of Directors. ČSOB also has had the **Audit Committee** as an independent governing body of ČSOB since January 2010. The General Meeting is the supreme body of the Company.

ČSOB updated its business model and made following changes effective as of 1 January 2013:

- ČSOB's Board of Directors and ČSOB's Top Management have eight members, instead of seven. Since 1 January 2013, Marek Ditz (Head of Corporate and Institutional Banking until 31 December 2012) has been appointed a new member of ČSOB's Board of Directors (decision by the KBC Bank as the sole shareholder of ČSOB of 21 December 2012).
- ČSOB's Organisation Chart and areas of responsibility managed by ČSOB's Board of Directors and ČSOB's Top Management were rearranged accordingly.

## ČSOB's Board of Directors

**In 2013**, the ČSOB's Board of Directors operated as the Bank's statutory and supreme executive body and had **eight members** all of whom were also Senior Executive Officers. Members of the ČSOB's Board of Directors are elected and removed by the General Meeting.

### ČSOB's Top Management

ČSOB's Top Management reports directly to the Board of Directors. ČSOB's Top Management consists of the Bank's senior employees in the positions of Chief Executive Officer and Senior Executive Officers. **In 2013**, ČSOB's Top Management had **eight members** who were identical with the ČSOB's Board of Directors.

**The composition of the ČSOB's Board of Directors and the Top Management from 1 January 2013:**

| | ČSOB's Board of Directors | | | ČSOB's Top Management | |
|---|---|---|---|---|---|
| First Name and Surname | Position | Membership since | The Beginning of the Member's Current Term of Office 1) | Position | The Beginning of Term of Office |
| Pavel Kavánek | Chairman 2) | 17. 10. 1990 | 20. 5.2009 | Chief Executive Officer | 29. 1. 1993 |
| Petr Hutla | Member | 27. 2. 2008 | 28. 2. 2013 3) | Senior Executive Officer<br>Specialized Banking and Insurance | 1. 1. 2013 |
| Marek Ditz | Member | 1. 1. 2013 | 1. 1. 2013 | Senior Executive Officer<br>Customer Relationships | 1. 1. 2013 |
| Petr Knapp | Member | 20. 5. 1996 | 20. 5. 2009 | Senior Executive Officer<br>Corporate Banking and Financial Markets | 1. 1. 2013 |
| Jan Lamser | Member | 26. 5. 1997 | 20. 5. 2009 | Senior Executive Officer<br>Convenience Services | 1. 1. 2013 |
| Bartel Puelinckx | Member | 8. 12. 2010 | 8. 12. 2010 | Senior Executive Officer<br>Finance Management | 1. 5. 2010 |
| Koen Wilmots | Member | 8. 12. 2010 | 8. 12. 2010 | Senior Executive Officer<br>Operations Management | 1. 1. 2013 |
| Jiří Vévoda | Member | 8. 12. 2010 | 8. 12. 2010 | Senior Executive Officer<br>Risk Management | 1. 1. 2013 |

*1) The term in office of the members elected prior to the amendment of ČSOB Articles in effect from 3 June 2011, lasts five years; in other cases it lasts four years.*
*2) Current chairman term since 20 May 2009.*
*3) Elected to a new term in office.*



**The ČSOB's Board of Directors and ČSOB's Top Management worked in the same composition throughout 2013.**

## Areas of Responsibility of ČSOB's Top Management

For a description of areas of responsibility managed by ČSOB's Top Management **as at 31 December 2013** please refer to the ČSOB's Organisation Chart, page 51 of this Annual Report.

# ČSOB's Supervisory Board

ČSOB's Supervisory Board supervises the exercising of the powers of the Board of Directors, the business of the Company and the manner in which it is conducted.

### ČSOB's Supervisory Board in 2013

| First Name and Surname | Position | Membership since | The Beginning of the Member's Current Term of Office [1] |
|---|---|---|---|
| Jan Švejnar | Chairman [2] | 9. 10. 2003 [3] | 20. 5. 2009 |
| Marko Voljč | Member | 29. 6. 2010 | 29. 6. 2010 |
| Patrick Roland Georges Zeno Vanden Avenne | Member | 22. 4. 2006 | 15. 6. 2011 |
| Hendrik George Adolphe Gerard Soete | Member | 24. 2. 2007 [3] | 20. 6. 2012 [5] |
| Jan Gysels | Member | 14. 2. 2013 | 14. 2. 2013 |
| Guy Libot | Member | 1. 12. 2010 | 1. 12. 2010 [6] |
| Philip Marck | Member | 1. 7. 2011 | 1. 7. 2011 [7] |
| František Hupka | Member [4] | 23. 6. 2005 | 23. 6. 2010 |
| Martina Kantová | Member [4] | 23. 6. 2010 | 23. 6. 2010 |
| Ladislava Spielbergerová | Member [4] | 23. 6. 2010 | 23. 6. 2010 |

*1) The term in office of the members elected prior to the amendment of ČSOB Articles in effect from 3 June 2011, lasts five years; in other cases it lasts four years.*
*2) Current chairman term since 3 June 2009.*
*3) Co-opted.*
*4) Elected by employees.*
*5) Elected to a new term in office.*
*6) Dismissed from 18 November 2013.*
*7) Dismissed from 14 February 2013.*

**The composition of the ČSOB's Supervisory Board from 18 November 2013**: Jan Švejnar (Chairman), Marko Voljč, Patrick Vanden Avenne, Hendrik Soete, Jan Gysels, František Hupka, Martina Kantová and Ladislava Spielbergerová.

# ČSOB's Audit Committee

ČSOB's Audit Committee acts as an independent body of ČSOB. Its members are elected out of members of the Supervisory Board or third persons. Members of the Audit Committee shall be elected and removed by the General Meeting.

### ČSOB's Audit Committee in 2013

| First Name and Surname | Position | | Membership since | Dismissed from |
|---|---|---|---|---|
| Guy Libot [1] | Chairman | Member of the ČSOB's Supervisory Board (until 18 November 2013) | 1. 12. 2010 | 18. 11. 2013 |
| Jan Švejnar | Member | Chairman of the ČSOB's Supervisory Board | 1. 1. 2010 [2] | – |
| Philip Marck | Member | Member of the ČSOB's Supervisory Board (until 14 February 2013) | 1. 7. 2011 | 5. 4. 2013 |
| Jan Gysels | Member | Member of the ČSOB's Supervisory Board | 5. 4. 2013 | – |
| Petr Šobotník | Independent member | Not a member of any ČSOB body | 1. 2. 2011 | – |

*1) Chairman of the ČSOB's Audit Committee from 1 July 2011 to 18 November 2013.*
*2) From 23 February 2007 to 31 December 2009, he was a member of the Audit Committee, a body of the ČSOB's Supervisory Board.*

**The composition of the ČSOB's Audit Committee from 18 November 2013**: Jan Švejnar, Jan Gysels and Petr Šobotník.

## Changes in the ČSOB's Managing and Supervisory Bodies in 2013

**On 21 December 2012**, KBC Bank as the sole shareholder of ČSOB decided as follows:

- Marek Ditz was appointed a member of the ČSOB's Board of Directors with effect from 1 January 2013.

**On 14 February 2013**, KBC Bank as the sole shareholder of ČSOB decided as follows:

- Philip Marck was dismissed from the ČSOB's Supervisory Board with effect from 14 February 2013.
- Jan Gysels was elected a member of the ČSOB's Supervisory Board with effect from 14 February 2013.
- Petr Hutla was re-elected a member of the ČSOB's Board of Directors with effect from 28 February 2013 (he has been a member of ČSOB's Board of Directors since February 2008).

**On 5 April 2013**, KBC Bank as the sole shareholder of ČSOB decided as follows:

- Philip Marck was dismissed from the ČSOB's Audit Committee with effect from 5 April 2013.
- Jan Gysels was appointed a member of the ČSOB's Audit Committee with effect from 5 April 2013.

**On 18 November 2013**, KBC Bank as the sole shareholder of ČSOB decided as follows:

- Guy Libot was dismissed from the ČSOB's Supervisory Board with effect from 18 November 2013 and from the ČSOB's Audit Committee with effect from 18 November 2013.

## Changes in the ČSOB's Managing and Supervisory Bodies in 2014

On 13 February 2014, KBC Group announced changes to the composition of the KBC Group Executive Committee and changes in KBC Group's organizational structure with effect from 1 May 2014:

- KBC Group Executive Committee will have six instead of eight members (Marko Voljč and Danny De Raymaeker will leave).
- John Hollows was appointed as the successor to Pavel Kavánek as a Chairman of ČSOB's Board of Directors and Chief Executive Officer (and a member of the Executive Committee of KBC Group responsible for the Business Unit Czech Republic). John Hollows is currently Chief Risk Officer and member of the KBC Group Executive Committee.

In addition, Mr. Jan Švejnar has expressed his intention to end his term of office (after more than 10 years) as Chairman of the Supervisory Board of ČSOB (his term of office ends on 20 May 2014) and devote more time to his academic career. Pavel Kavánek is scheduled to replace Jan Švejnar as a Chairman of the Supervisory Board.

For a description of areas of responsibility managed by ČSOB's Top Management since 1 May 2014 please refer to the ČSOB's Organisation Chart, page 52 of this Annual Report.

## 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, the ČSOB's Top Management and the Supervisory Board to ČSOB and their private interests and / or other duties.

*ČSOB, pursuant to the applicable Czech legal principles, doesn't regard entering into banking transactions by the members of the Board of Directors, the members of the 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**
**Czech Republic**

# Emoluments and Benefits of Persons Discharging Managerial Responsibilities

*Information in accordance with the Act No. 256/2004 Coll., Act on Business Activities on the Capital Market (also known as the Act on undertakings on the capital market), section 118, paragraph 4, provisions f), g) and h)*

**Persons discharging managerial responsibilities** within an issuer* in ČSOB are:

(i) The Chairman of the Board of Directors, who is also the Chief Executive Officer, and other Members of the Board of Directors, who also act as Senior Executive Officers, constitute the ČSOB's Top Management (for details refer to Managing and Supervisory Bodies) and (ii) Members of the Supervisory Board.

In 2013, ČSOB did not have any persons discharging managerial responsibilities as defined in the Act No. 256/2004 Coll., Act on Business Activities on the Capital Market, Section 2, paragraph 1, provision b) 4.

For description of areas of responsibility managed by ČSOB's Chief and Senior Executive Officers please refer to the ČSOB's Organisation Chart on page 51 of this Annual Report. Descriptions of work and decision-making processes are given in "Corporate Governance" on pages 47–50 of this Annual Report.

* *Persons discharging managerial responsibilities within an issuer (in Czech "osoby s řídící pravomocí") as defined in the act above.*

## Monetary and Non-monetary Income

*(Section 118, paragraph 4, provision f)*

In 2013, **persons discharging managerial responsibilities** received the following income from both ČSOB and persons controlled by ČSOB:

| | Monetary Income | | Non-monetary Income | |
|---|---|---|---|---|
| | Received from | | Received from | |
| (CZKths) | ČSOB | Persons Controlled by ČSOB | ČSOB | Persons Controlled by ČSOB |
| Members of the Board of Directors | 90,655 | 0 | 7,776 | 0 |
| Members of the Supervisory Board | 3,292 | 0 | 33 | 0 |
| Other members of the Top Management | No such persons in 2013 | | | |

The income of the Chairman and Members of the Board of Directors in 2013 included: CZK 72,540 ths under the Contracts on the Performance of the Line Management Function, and remuneration totalling CZK 18,115 ths under the Contracts on the Performance of the Function of the Member of the Board of Directors. The income of the Members of the Supervisory Board consisted of CZK 2,359 ths under the Contract on the Performance of the Function of the Chairman / Member of the Supervisory Board, and the income under employment contracts of CZK 933 ths.

Non-monetary income includes e.g. a company car, fuels, costs of training, and also contributions to pension plans and life insurance.

## Shares Issued by ČSOB

*(Section 118, paragraph 4, provision g)*

As at 31 December 2013, the Members of the Board of Directors and their next of kin, the members of the Supervisory Board and their next of kin did not own any shares issued by ČSOB and were not holders of any purchase option on ČSOB shares.

## Principles of Remuneration

*(Section 118, Paragraph 4, provision h)*

### Members of the Board of Directors

ČSOB's Supervisory Board established for remuneration, nomination and personal issues the Nomination and Remuneration Committee. The Remuneration Rules are approved by this Committee of Supervisory Board as well as fulfilment of upfront performance targets (Key Performance Indicators; "KPIs") based on their evaluation by the Chairman of the Board of Directors. Members of Nomination and Remuneration Committee in 2013 were Marko Voljč (Chairman; member of the Supervisory Board), Jan Švejnar (Chairman of the Supervisory Board) and Guy Libot (member of the Supervisory Board until 18 November 2013).

Members of the Board of Directors also serve as Senior Executive Officers with specific agendas. Their income comprises a fixed remuneration for performing the function of a member of the Board of Directors and a fixed salary for performing the management function of a Senior Executive Officer. A variable part of remuneration is derived from the fixed part and depends on meeting upfront performance targets (KPIs), including financial (e.g. net profit, operating expenses), risk (e.g. credit costs) and other (e.g. number of clients) parameters. The variable part of remuneration is approximately one third of all income. KPIs are assessed on an annual basis at the end of ČSOB's fiscal year. Results achieved as at 31 December of the assessed year are taken into consideration.

Following the change of the legislation, a new bonus scheme for persons discharging managerial responsibilities within an issuer was launched in 2011. A half of the bonus is provided in non-cash instruments. Payment of a half of the bonus (both cash and non-cash portion) is deferred up to the next three years following the initial assignment of the benefit and is linked to fulfilling all conditions according to internal rule of Remuneration Policy.

### Members of the Supervisory Board

Only the Chairman of ČSOB's Supervisory Board is remunerated for his membership of the Supervisory Board. The Chairman of the Supervisory Board is contracted for fixed salary per year that is set by the Nomination and Remuneration Committee and approved by the General Meeting. Other members receive no remuneration from ČSOB or KBC for their Supervisory Board membership. Supervisory Board members – KBC employees receive neither income from ČSOB for their Supervisory Board membership, nor any extra remuneration from KBC.

# Introducing Members of Managing and Supervisory Bodies

## ČSOB's Board of Directors and ČSOB's Top Management

**Pavel Kavánek**

*(Born on 8 December 1948)*

Chairman
of the Board of Directors
and Chief Executive Officer

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

Mr. Kavánek has been working for ČSOB since 1972. He has been member of the Board of Directors of ČSOB since 1990 and its Chairman and the CEO since 1993.

Since 1 January 2013, Mr. Kavánek has been a member of the Executive Committee of KBC Group responsible for the Business Unit Czech Republic.

*Membership in bodies of other companies:*
President of the Executive Board of the Czech Banking Association; Chairman of the Supervisory Board of the Dagmar and Václav Havel Foundation VIZE 97 (membership until 31 December 2013); member of the Board of Trustees of the Aspen Institute Prague.

**Petr Hutla**

*(Born on 24 August 1959)*

Member
of the Board of Directors
and Senior Executive Officer,
Specialized Banking and
Insurance

He graduated from the Czech Technical University, 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. Since 1 January 2013, he has been a member of ČSOB's Top Management as the Senior Executive Officer, Specialized Banking and Insurance.

*Membership in bodies of other companies:*
Chairman of the Supervisory Board in: Hypoteční banka (CZ) ČSOB Factoring (CZ) and ČSOB Leasing (CZ); Deputy Chairman of the Supervisory Board of ČMSS (CZ); member of the Board of Trustees of Czech Technical University in Prague and member of the Board of Directors of the Czech Transplant Foundation.

**Marek Ditz**

*(Born on 16 September 1972)*

Member
of the Board of Directors
and Senior Executive Officer,
Customer Relationships

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 Specialized 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 and a member of ČSOB's Top Management as the Senior Executive Officer, Customer Relationships.

*Membership in bodies of other companies:*
Chairman of the Supervisory Board of ČSOB Advisory (CZ).

**Petr Knapp**

*(Born on 7 May 1956)*

Member
of the Board of Directors
and Senior Executive Officer,
Corporate Banking
and Financial Markets

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. Since 1 January 2013, Mr. Knapp has been a member of ČSOB's Top Management as the Senior Executive Officer, Corporate Banking and Financial Markets.

*Membership in bodies of other companies:*
Member of the Supervisory Board of ČSOB Factoring (CZ); member of the Board of Directors of the Prague Economic Chamber (CZ).

**Jan Lamser**

*(Born on 8 December 1966)*

Member
of the Board of Directors
and Senior Executive Officer,
Convenience Services

He graduated from the Faculty of Mathematics and Physics and the Protestant Theological Faculty of the Charles University of Prague; the University of Economics, Prague and École des Hautes Études Commerciales, Paris.

Mr. Lamser has been working for ČSOB since 1995. He has been a member of the Board of Directors since 1997. He worked in various managerial positions in ČSOB. Until 31 December 2012, he was responsible for services provided to mass retail clientele. Since 1 January 2013, Mr. Lamser has been a member of ČSOB's Top Management as the Senior Executive Officer, Convenience Services.

*Membership in bodies of other companies:*
Member of the Supervisory Board of ČMSS (CZ); Chairman of the control commission of the Unijazz Association (CZ); President of the Czech Chess Union.

**Bartel Puelinckx**

*(Born on 16 December 1965)*

Member
of the Board of Directors
and Senior Executive Officer,
Finance Management

He studied economics at the University of Leuven (Belgium) and law at the University of Brussels.

Mr. Puelinckx has worked in the KBC Group since 1992, in various positions within KBC Bank. In addition, he worked in Hungary's K&H Bank from 2006 to 2010, most recently as Senior Managing Director, Head of HR & Credit Management Division. Since 1 May 2010, he has been a member of ČSOB's Top Management as the Senior Executive Officer, Finance Management (CFO). Since 8 December 2010, he has been a member of the Board of Directors.

*Membership in bodies of other companies:*
None.

**Koen Wilmots**

*(Born on 24 July 1964)*

Member
of the Board of Directors
and Senior Executive Officer,
Operations Management

He studied law at the Catholic University of Leuven (Belgium), followed by a post-graduate course at the Robert Schuman University in Strasbourg.

Mr. Wilmots has worked in the banking sector since 1992 when he joined Kredietbank. He has been working for ČSOB since 1999. Between 1999 and 2005, he was responsible for Corporate Management and Distribution Segment. He was the Executive Director, Credits between 2005 and 30 April 2010. Mr. Wilmots was a member of ČSOB's Top Management as the Senior Executive Officer responsible for Risk Management between 1 May 2010 and 31 December 2012. He has been a member of the Board of Directors since 8 December 2010. Since 1 January 2013, Mr. Wilmots has been a member of ČSOB's Top Management as the Senior Executive Officer, Operations Management.

*Membership in bodies of other companies:*
None.

**Jiří Vévoda**

*(Born on 4 February1977)*

Member
of the Board of Directors
and Senior Executive Officer,
Risk 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. First Mr. Vévoda has acted as the Senior Executive Officer responsible for HR and Trasformation and then as the Senior Executive Officer responsible for Products and Staff Functions. He has become a member of the Board of Directors since 8 December 2010. Since 1 January 2013, Mr. Vévoda has been a member of ČSOB's Top Management as the Senior Executive Officer, Risk Management (CRO).

*Membership in bodies of other companies:*
Member of the Supervisory Board in: Hypoteční banka (CZ) and ČSOB Leasing (CZ).

## ČSOB's Supervisory Board

**Jan Švejnar**

*(Born on 2 October 1952)*

Chairman
of the Supervisory Board

He graduated from Cornell University (USA) with a degree in Industrial and Work Relations, and obtained a Ph.D. in Economics from Princeton University.

Mr. Švejnar is an independent economist living abroad since 1970. Since 1992, he has divided his work capacity between activities in Prague and the USA. He has primarily devoted his academic career to economies in transition and, generally, to economic development. He was a professor at the University of Michigan Business School and since the beginning of 2012 he serves at Columbia University in New York as the founding director of the Center for Global Economic Governance.

He is a member of the ČSOB's Audit Committee.

*Membership in bodies of other companies:*
Chairman of the Board of the Center for Economic Research and Graduate Education (CERGE) of the Charles University; member of the Academic Council of Faculty of Social Sciences of the Charles University; member of the Czech government's National Economic Council (NERV); Chairman of the Regional Association's Economic Council (ERAK).

**Marko Voljč**

*(Born on 5 December 1949)*

Member
of the Supervisory Board

He graduated from the University of Ljubljana and Belgrade, with a degree in economics.

Between 1976 and 1979, Mr. Voljč was head of the analytical department of the National Bank of Slovenia. From 1979 through 1992, he worked for the World Bank in Washington D.C. and Mexico City. In 1992, he joined Nova Ljubljanska Banka in Slovenia as its President and the Chief Executive Officer (CEO). In 2004, he became General Manager of the Central Europe Directorate at KBC headquarters in Brussels. In that capacity, he served on the supervisory boards of KBC's banking subsidiaries in Poland, Hungary and the Czech Republic. From May 2006 to April 2010, he was CEO of K&H Bank (KBC Group) in Budapest and also became Country Manager of the Hungarian operations. Since 29 April 2010, he has been a member of the Executive Committee of the KBC Group. From 29 April 2010 to December 2012, he was CEO of the KBC Group's Central & Eastern Europe and Russia business unit. Since 1 January 2013, he has been a member of the Executive Committee of the KBC Group (Chief Change Officer) responsible for the Corporate Change & Support business unit.

*Membership in bodies of other companies:*
Member of the Board of Directors of K&H Bank (Hungary); Chairman of the Supervisory Board in: ČSOB Pojišťovna (CZ) and DZI (Bulgaria); member of the Supervisory Board in: ČSOB (SK) and CIBank (Bulgaria).

**Patrick Roland Georges Zeno Vanden Avenne**

*(Born on 15 February 1954)*

Member
of the Supervisory Board

He graduated from the Catholic University in Leuven (Belgium) with a degree in economics and law, and Stanford University (USA) with a degree in business administration.

Mr. Avenne owns and manages a number of companies in the food processing industries and in logistics. As a significant shareholder of KBC, he has participated in the corporate governance of KBC Group since 1993. He had also been in managerial positions in Almanij (a former parent company of the KBC Group), Gevaert NV and, later, in KBC Bank and KBC Insurance. After the merger of Almanij and KBC in 2005, he was appointed to the position of Director of KBC Bank and became a member of the Audit Committee at KBC Bank. Since 22 April 2006, he has been a member of ČSOB's Supervisory Board.

*Membership in bodies of other companies:*
Member of the Supervisory Boards at the Catholic Universities in Leuven and Kortrijk, member of the managing committees of the Flemish Employers Union (VOKA) and the Belgian Federation of Food Industry (Bemefa).

**Hendrik George Adolphe Gerard Soete**

*(Born on 9 November 1950)*

Member
of the Supervisory Board

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. At present, he is the Executive Chairman of the Board of Directors of the AVEVE Group.

*Membership in bodies of other companies:*
Member of the Board of Directors of the MRBB, the Financial Holding of Boerenbond (Belgium); CEO of the Agri Investment Fund of Boerenbond (Belgium); Chairman of the Covalis Meat Group (Belgium).

**Jan Gysels**

*(Born on 28 September 1960)*

Member
of the Supervisory Board
(since 14 February 2013)

He graduated from the Catholic University in Leuven (Belgium) with a degree in law in 1983 and he obtained post–graduate diploma in Business Management and in Maritime Studies in 1984.

Mr. Gysels has been working for KBC since 1985. Between 1987 and 2009, he held various positions in the KBC group in Belgium and Hungary. From 2009 to 2012, he worked as the General Manager of KBC Communication Division in Belgium. Since January 2013, he has worked in the position of the General Manager Banking Communities Support in the KBC Global Services.

Since 14 February 2013, he has been a member of ČSOB's Supervisory Board.

Since 5 April 2013, he has been a member of the ČSOB's Audit Committee.

*Membership in bodies of other companies:*
Member of the Board of Directors (a non-executive director) of KBC Bank Ireland (Ireland); member of the Supervisory Board in: ČSOB (SK), CIBank (Bulgaria) and K&H Bank (Hungary).

**František Hupka**

*(Born on 13 April 1971)*

Member
of the Supervisory Board
elected by employees

He obtained a bachelor degree in Economics and Management from the University of Western Bohemia in Pilsen.

In 1991, Mr. Hupka joined ČSOB as an IT support specialist. Since 2002, he has served as the Chairman of the Bank's Trade Union Committee. He has been a member of ČSOB's Supervisory Board elected by employees since June 2005.

*Membership in bodies of other companies:*
Member of the Management Board of the Occupational Health Insurance Company (OZP).

| | |
|---|---|
| **Martina Kantová**<br>*(Born on 31 March 1974)*<br>Member<br>of the Supervisory Board<br>elected by employees | She graduated from the Secondary school of economics in Hradec Králové.<br>Ms. Kantová has been working for ČSOB (formerly IPB) at a branch in Hradec Králové since 1996. From 2005 to August 2012, she worked as a Retail Credits Advisor. Since September 2012, Ms. Kantová has been on a maternity leave. She has been a member of KBC's European Worker Council since 2008. She has been a member of the Bank's Trade Union Committee since 2007. Between 2009 and 2012, Ms. Kantová was the chairperson of a local trade union organization in Hradec Králové. In 2013, after the merger two local trade union organizations in Hradec Králové and in Prague, she was a member of the board of the new local trade union organization. Since 2014, she has been a member of local trade union organization in Pilsen.<br>*Membership in bodies of other companies:*<br>None. |
| **Ladislava Spielbergerová**<br>*(Born on 6 November 1974)*<br>Member<br>of the Supervisory Board<br>elected by employees | She obtained a bachelor degree from the Banking Institute/College of Banking in Prague.<br>Ms. Spielbergerová has been working for ČSOB since 1995. From 2010 to April 2013, she worked as a Personal Banker at the branch in Dvůr Králové nad Labem. At present, Ms. Spielbergerová is on a maternity leave. She has been a member of KBC's European Worker Council since 2005 and the Deputy Chairman of the Bank's Trade Union Committee since 2008.<br>*Membership in bodies of other companies:*<br>None. |

## ČSOB's Audit Committee

| | |
|---|---|
| **Petr Šobotník**<br>*(Born on 16 May 1954)*<br>Independent member<br>of the Audit Committee | He graduated from the University of Economics, Prague.<br>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 in PricewaterhouseCoopers from 1998 to 2002. He then worked in various top management positions in PwC until June 2010. At present, he is an independent consultant.<br>Since 1 February 2011, he has been an independent member of the ČSOB's Audit Committee.<br>*Membership in bodies of other companies:*<br>President of the Czech Chamber of Auditors since 2007 (re-elected in November 2012 for another two-year term); representative of the Czech Republic in FEE – Ethics Working Party since 2004; member of the Audit Committee in Skanska a.s. (since 2010); representative of the Czech Republic at the global organisation of accountants IFAC (since 2007). |

## Termination of membership in the ČSOB's Supervisory Board and in the ČSOB's Audit Committee in 2013

**Philip Marck**

*(Born on 4 February 1959)*

He studied at the Catholic University of Leuven (Belgium) and graduated at faculty of law of in 1982 and audio-visual communication media in 1983. Mr. Marck completed a degree in Business Management at the EHSAL Management School in Brussels in 1992.

Mr. Marck started his career at Kredietbank in 1984 and subsequently held the position of a branch manager, first in retail branches and later in different corporate branches. In 2007, he became the Regional Manager Corporate Banking for the Brussels-Brabant-Limburg region. A year later, he was appointed the General Manager, Corporate Banking Belgium in KBC Bank. At present, he is the Regional Director for the Brussels-Oost-Brabant region.

From 1 July 2011 to 14 February 2013, Philip Marck was a member of the ČSOB's Supervisory Board. From 1 July 2011 to 5 April 2013, he was a member of the ČSOB's Audit Committee.

*Membership in bodies of other companies:*
Member of the Board of Directors (a non-executive body) of KBC Banka (Serbia).

**Guy Libot**

*(Born on 1 March 1963)*

He holds a master's degree from University of Antwerp in applied economics and commercial engineering.

Between 1989 and 1995, Mr. Libot worked for Kredietbank in the USA and the Netherlands. Between 1995 and 2003, he worked for KBC Bank – first as the Branch General Manager in Singapore and later as the CEO in the Netherlands. He became the Deputy President of Kredyt Bank in Poland and in 2003 and the Deputy CEO of K&H Bank in Hungary in 2006. In 2010, he became the General Manager, Banking, Central & Eastern Europe and Russia within the KBC Global Services. One year later, he was appointed by the KBC Group to serve as the Senior General Manager Banking, for Central & Eastern Europe and Russia. In 2013, Mr. Libot acted as theSenior General Manager, Banking Core Communities (part of the Corporate Change & Support business unit). Since December 2013, he has been the Senior General Manager, Corporate Audit, in the KBC Group.

From 1 December 2010 to 18 November 2013, Guy Libot was a member of the ČSOB's Supervisory Board. From 1 December 2010 to 18 November 2013, he was a member of the ČSOB's Audit Committee (a Charmain from 1 July 2011 to 18 November 2013).

*Membership in bodies of other companies:*
President of the Board of Directors (a non-executive body) of KBC Banka (Serbia); member of the Board of Directors of K&H Bank (Hungary); Deputy Chairman of the Supervisory Board of CIBank (Bulgaria); member of the Supervisory Board of ČSOB (SK).

# 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.**

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

Effective from October 2012, **ČSOB's Anti-Corruption Programme Policy** 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 ČSOB's Articles of Association** as approved by the General Meeting. Increase of the number of members on the Board of Directors from seven to eight (from 1 January 2013) was the main change made in 2013. Pursuant to Act no. 90/2012 Coll., on Business Corporations, new ČSOB's Articles of Association were adopted as of 1 January 2014.

## General Meeting

**The General Meeting of shareholders is ČSOB's supreme body**. 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 ČSOB's bodies, or amendments to the Articles of Association, or changes in the registered capital. The General Meeting also approves financial statements. **The sole shareholder (KBC Bank NV) exercises the powers of the 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 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 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.

**In 2013, ČSOB's Board of Directors had eight members and worked in the following composition**: Pavel Kavánek (Chairman), Petr Hutla, Petr Knapp, Jan Lamser, Bartel Puelinckx, Koen Wilmots, Jiří Vévoda and Marek Ditz. Effective as of 28 February 2013, Mr. Petr Hutla was re-elected as a member of the Board of Directors for another term.

**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 director of the Bank's Corporate Office who acts as secretary of the Board of Directors and is responsible for preparing the meetings and taking their minutes. The Board of Directors has a 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 in 2013

### Risk and Capital Oversight Committee (RCOC)

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

### Credit Sanctioning Committee (CSC)

The Committee decides approvals/non-approvals of credit exposure in cases within the ČSOB decision-making powers.

### Enterprise Architecture Board (EAB)

The Committee manages and monitors the transformation in the field of business and information technology governance (Business IT Governance) and provides evaluation and methodological management of the processes within the area.

### 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.

### ČSOB Corporate Social Responsibility Committee (CSRC)

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

### 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.

## Other Bodies

### EXCO – Executive Committee Corporate and Financial Markets

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

**EXCO – Executive Committee Customer Relations and Convenience Services**

A committee of strategic importance to ensure implementation of business and strategic initiatives and customer value proposition for relationship banking and convenience services in accordance with the powers delegated by ČSOB's Board of Directors and ČSOB group's 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.

**In 2013, ČSOB's Supervisory Board had nine members** (eight members as from 18 November 2013), six of them were elected by the General Meeting and three of them were elected by the company's employees.

**Throughout 2013, ČSOB's Supervisory Board worked in the following composition**: Jan Švejnar (Chairman), Marko Voljč, Patrick Vanden Avenne, Hendrick Soete, Philip Marck (withdrawn by the decision of the sole shareholder as of 14 February 2013), Jan Gysels (appointed as a member of the Supervisory Board by the decision of the sole shareholder as of 14 February 2013), Guy Libot (withdrawn by the decision of the sole shareholder as of 18 November 2013), František Hupka, Martina Kantová and Ladislava Spielbergerová.

**In compliance with its plan of work, the Supervisory Board held four meetings in 2013** where it discussed issues falling under its responsibility according to the Bank's Articles of Association. 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 materials to be discussed. In compliance with its powers, the Supervisory Board selected an external auditor. The auditor attends all meetings of the Audit Committee, thus providing an independent, comprehensive and qualified opinion of whether ČSOB's financial statements reflect the 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 Bank's Corporate Office, whose director is responsible for taking the minutes of the meetings. Constitution of a quorum and the majority necessary to adopt a decision follow the same principles as in the case of the Board of Directors.

### Supervisory Board Committee

**The Remuneration and Nomination Committee** is an advisory and nomination body of the Supervisory Board. The Remuneration and Nomination Committee sets, assesses and evaluates the remuneration of ČSOB's top managers; the Committee meets as necessary but no less than once a year. **In 2013, the Remuneration and Nomination Committee was composed of the following members**: Marko Voljč (Chairman), Jan Švejnar and Guy Libot (until 18 November 2013).

## Audit Committee

The Audit Committee is an official body of ČSOB. Its authority and responsibilities are determined by the ČSOB's Articles of Association and the Audit Committee's Rules of Procedure. In particular, the Audit Committee monitors the compilation of the financial statements and the process of mandatory audit, supervises and monitors the quality of internal control, the work of Internal Audit, the Compliance unit, financial reporting and the system of risk management. The Audit Committee recommends a statutory auditor and examines the adequacy of the auditor's independence.

**The Audit Committee has four members** elected from among the members of the Supervisory Board or third parties.

**In 2013, the Audit Committee worked in the following composition**: Guy Libot (Chairman; withdrawn by the decision of the sole shareholder upon his request as of 18 November 2013), Jan Švejnar, Philip Marck (withdrawn by the decision of the sole shareholder as of 5 April 2013), Jan Gysels (appointed by the decision of the sole shareholder as of 5 April 2013) and Petr Šobotník (independent member).

**The Audit Committee members are elected by the General Meeting** based on their expertise that is required to perform their control tasks in a professional manner. The CEO of ČSOB, members of the ČSOB's Board of Directors, the External Auditor, the manager of the ČSOB's Compliance unit, the head of ČSOB Internal Audit and head of KBC Internal Audit participate as permanent guests in all 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. **In compliance with its plan of work, the Audit Committee held four meetings in 2013** where issues falling within the Audit Committee's competence were addressed. 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.

## Internal Control Mechanisms to Eliminate 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 or manual entries in accounts with automatic accounting etc. Control procedures are set up to eliminate the risk of accounting errors and fraud. Corrections of accounting errors are monitored centrally. The adequacy and effectiveness of the accounting examinations are assessed on a regular basis. Findings are reported to the Internal Audit and Operational Risk Committee 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 possibility of unauthorised entry is eliminated 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 via Accounting Methodology which further cooperates with the units concerned. Applicable accounting policies, e.g. rules for measuring the assets or principles of creation of allowances and provisions, are described in Note 2 to the Separate Financial Statement for the year 2013 prepared in accordance with EU IFRS and in Note 2 to the Consolidated Financial Statement for the year 2013 prepared in accordance with EU IFRS.

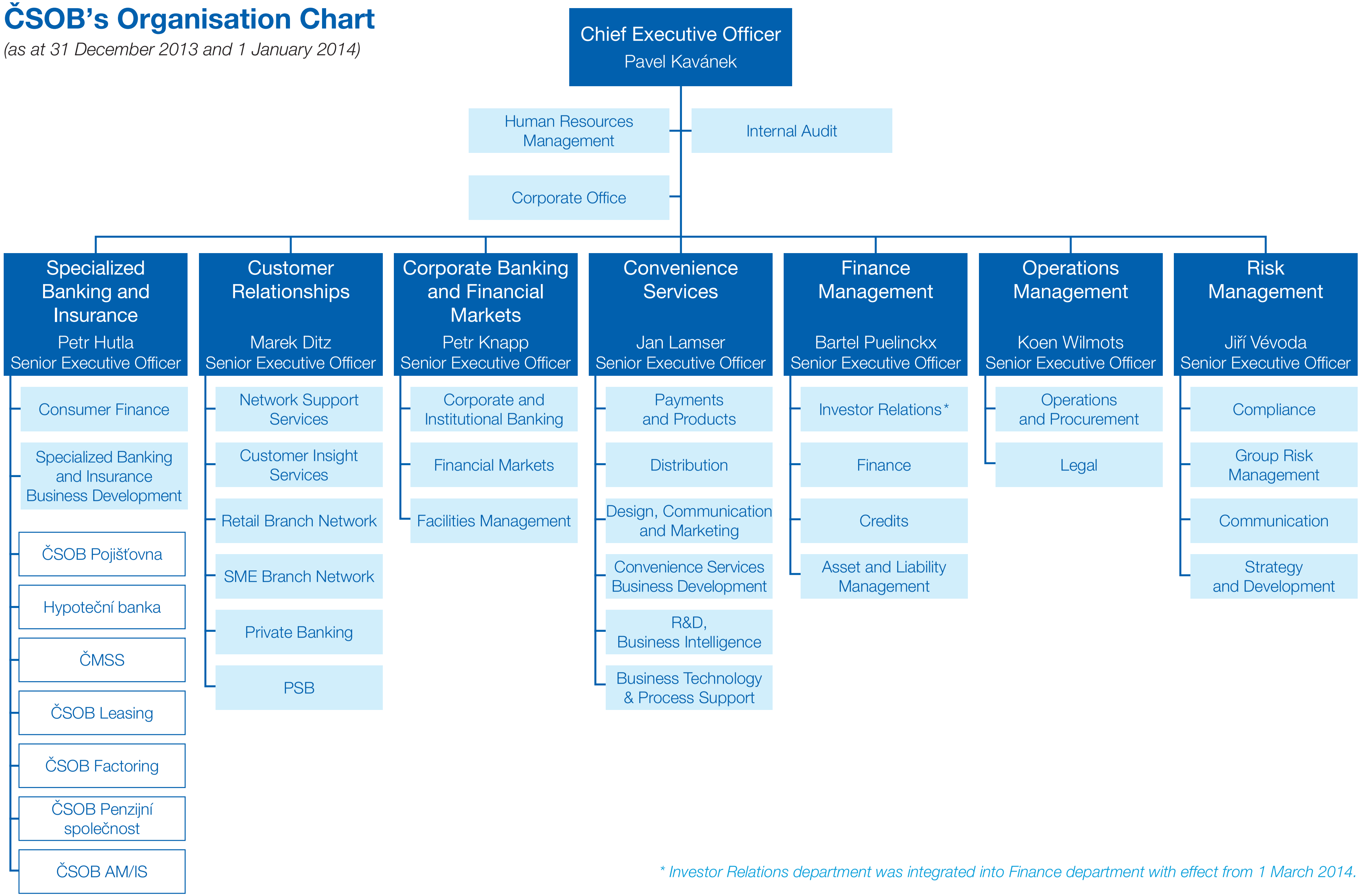
Control mechanisms are extended based on recommendations from internal audit, or based on outcomes of the risk assessment reviews organized as part of the operational risk management, please refer to Note 38.5 to the Separate Financial Statement for the year 2013 prepared in accordance with EU IFRS and to Note 40.5 to the Consolidated Financial Statement for the year 2013 prepared in accordance with EU IFRS.

An automated system is used to prepare majority of financial statements using the data from the central data warehouse, which are reconciled to the General Ledger balances.

Consolidated financial statements are regularly submitted to the company's Supervisory Board and both consolidated and separate financial statements are subject to external audit. The effectiveness and efficiency of internal controls is evaluated by internal auditors. Financial reporting review is submitted to the Audit Committee on a half year basis.

# ČSOB's Organisation Chart

*(as at 31 December 2013 and 1 January 2014)*

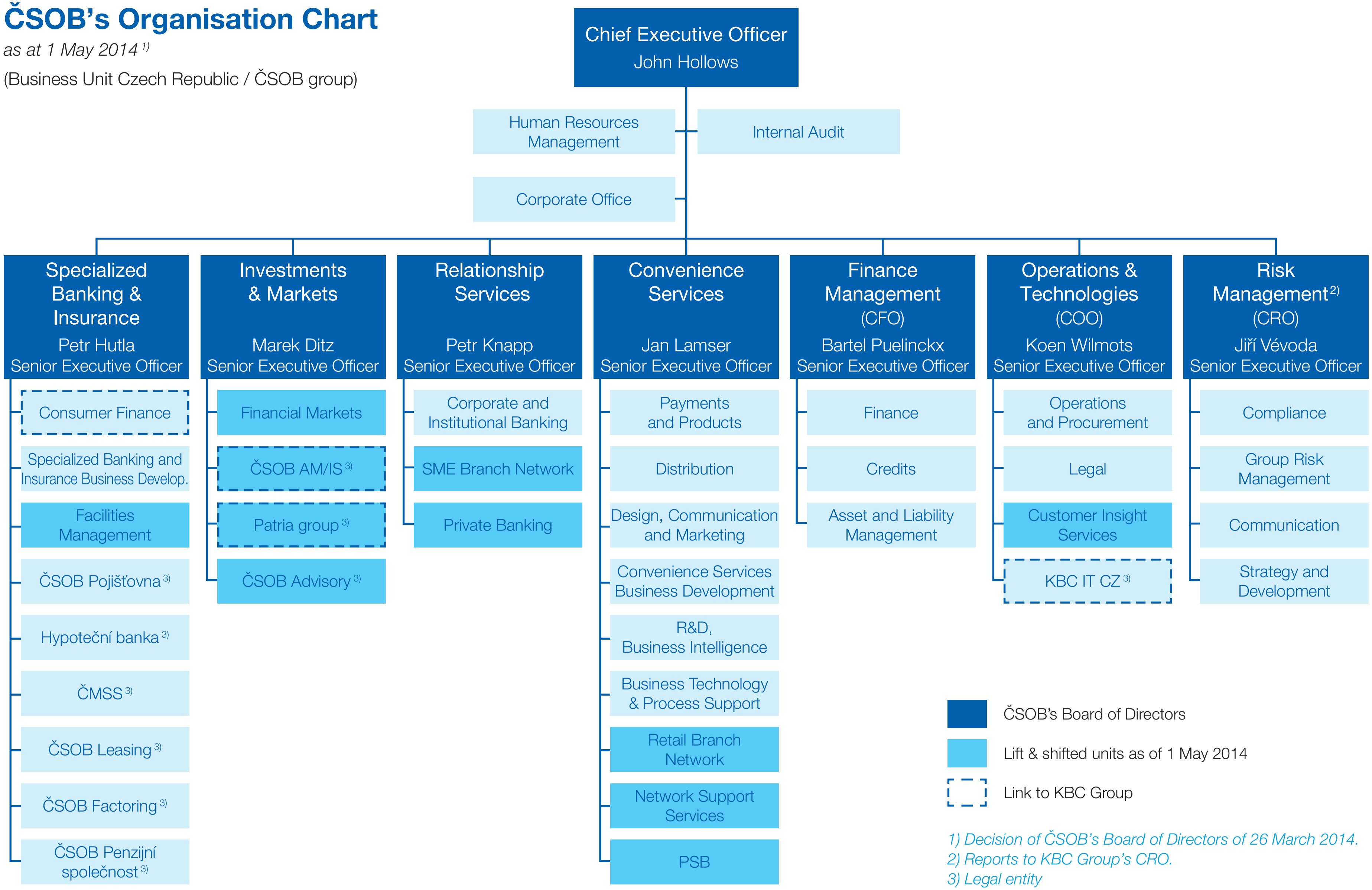



** Investor Relations department was integrated into Finance department with effect from 1 March 2014.*

# ČSOB's Organisation Chart

*as at 1 May 2014* [1)]

(Business Unit Czech Republic / ČSOB group)




*1) Decision of ČSOB's Board of Directors of 26 March 2014.*
*2) Reports to KBC Group's CRO.*
*3) Legal entity*

# FINANCIAL PART

# INDEPENDENT AUDITOR'S REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

EY
Building a better working world

## INDEPENDENT AUDITOR'S REPORT

To the Shareholder of Československá obchodní banka, a. s.:

We have audited the accompanying consolidated financial statements of Československá obchodní banka, a. s. and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. For details of the Group, see Note 1 to the consolidated financial statements.

*Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Building a better working world

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2013, and 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.

Ernst & Young

Ernst & Young Audit, s.r.o.
License No. 401
Represented by

Douglas Burnham
Partner

Jan Zedník
Auditor, License No. 2201

27 March 2014
Prague, Czech Republic

## *CONSOLIDATED STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| Interest income | 5 | 30,229 | 32,697 |
| Interest expense | 6 | (6,164) | (7,727) |
| **Net interest income** | | **24,065** | **24,970** |
| Fee and commission income | | 9,121 | 8,747 |
| Fee and commission expense | | (3,138) | (3,242) |
| **Net fee and commission income** | 7 | **5,983** | **5,505** |
| Dividend income | | 10 | 26 |
| Net gains from financial instruments at fair value through profit or loss and foreign exchange | 8 | 2,046 | 2,315 |
| Net realised gains on available-for-sale financial assets | | 408 | 126 |
| Other net income | 9 | 485 | 2,073 |
| **Operating income** | | **32,997** | **35,015** |
| Staff expenses | 10 | (7,030) | (7,222) |
| General administrative expenses | 11 | (7,669) | (8,009) |
| Depreciation and amortisation | 22, 23 | (832) | (856) |
| **Operating expenses** | | **(15,531)** | **(16,087)** |
| Impairment losses | 12 | (1,447) | (1,584) |
| Share of profit of associates | 19 | 52 | 195 |
| **Profit before tax** | | **16,071** | **17,539** |
| Income tax expense | 13 | (2,420) | (2,258) |
| **Profit for the year** | | **13,651** | **15,281** |
| **Attributable to:** | | | |
| Owners of the parent | | 13,658 | 15,291 |
| Non-controlling interests | | (7) | (10) |

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

## *CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| **Profit for the year** | | **13,651** | **15,281** |
| Exchange differences on translating foreign operation | | 2 | (1) |
| Net (loss) / gain on cash flow hedges | | (1,261) | 2,449 |
| Net (loss) / gain on available-for-sale financial assets | | (1,180) | 3,837 |
| Share of other comprehensive income of associates | | - | (188) |
| Income tax benefit / (expense) relating to components of other comprehensive income | | 420 | (1,027) |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | 31 | **(2,019)** | **5,070** |
| **Total comprehensive income for the year, net of tax** | | **11,632** | **20,351** |
| **Attributable to:** | | | |
| Owners of the parent | | 11,639 | 20,368 |
| Non-controlling interests | | (7) | (17) |

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

## *CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with central banks | 15 | 55,036 | 28,293 |
| Financial assets held for trading | 16 | 204,729 | 162,265 |
| Financial assets designated at fair value through profit or loss | 16 | 7,467 | 7,352 |
| Available-for-sale financial assets | 17 | 83,340 | 91,904 |
| Held-to-maturity investments | 17 | 150,944 | 138,437 |
| Loans and receivables | 18 | 509,256 | 479,516 |
| Fair value adjustments of the hedged items in portfolio hedge | | 927 | 1,030 |
| Derivatives used for hedging | 20 | 9,285 | 14,453 |
| Current tax assets | | 99 | 17 |
| Deferred tax assets | 13 | 96 | 88 |
| Investment in associate | 19 | 124 | 126 |
| Investment property | 21 | 289 | 430 |
| Property and equipment | 22 | 7,787 | 8,045 |
| Goodwill and other intangible assets | 23 | 3,234 | 3,093 |
| Non-current assets held-for-sale | 24 | 194 | 85 |
| Other assets | 25 | 2,023 | 2,040 |
| **Total assets** | | **1,034,830** | **937,174** |
| **LIABILITIES AND EQUITY** | | | |
| Financial liabilities held for trading | 26 | 186,920 | 133,587 |
| Financial liabilities at amortised cost | 27 | 743,165 | 703,792 |
| Fair value adjustments of the hedged items in portfolio hedge | | (57) | 1,741 |
| Derivatives used for hedging | 20 | 9,507 | 9,166 |
| Current tax liabilities | | 913 | 772 |
| Deferred tax liabilities | 13 | 2,057 | 2,532 |
| Other liabilities | 28 | 10,985 | 10,508 |
| Provisions | 29 | 887 | 935 |
| **Total liabilities** | | **954,377** | **863,033** |
| Share capital | 30 | 5,855 | 5,855 |
| Share premium | | 15,509 | 7,509 |
| Statutory reserve | | 18,687 | 18,687 |
| Retained earnings | | 32,949 | 32,611 |
| Available-for-sale reserve | 30 | 4,699 | 5,701 |
| Cash flow hedge reserve | 30 | 2,548 | 3,567 |
| Foreign currency translation reserve | 30 | 2 | - |
| Shareholders' equity | | 80,249 | 73,930 |
| Non-controlling interests, presented within equity | | 204 | 211 |
| **Total equity** | | **80,453** | **74,141** |
| **Total liabilities and equity** | | **1,034,830** | **937,174** |

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 27 March 2014 by:

Pavel Kavánek
Chairman of the Board of Directors
and Chief Executive Officer

Bartel Puelinckx
Member of the Board of Directors
and Chief Finance Officer

## *CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2013*

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[1] | Retained earnings | Other reserves (Note: 30) | | |
| **At 1 January 2012** | **5,855** | **7,509** | **18,687** | **24,061** | **4,191** | **880** | **61,183** |
| Profit for the year | - | - | - | 15,291 | - | (10) | 15,281 |
| Other comprehensive income for the year | - | - | - | - | 5,077 | (7) | 5,070 |
| Total comprehensive income for the year | - | - | - | 15,291 | 5,077 | (17) | 20,351 |
| Results from the loss of a control in a subsidiary | - | - | - | (145) | - | (652) | (797) |
| Dividends paid (Note: 14) | - | - | - | (6,596) | - | - | (6,596) |
| **At 31 December 2012** | **5,855** | **7,509** | **18,687** | **32,611** | **9,268** | **211** | **74,141** |
| **At 1 January 2013** | **5,855** | **7,509** | **18,687** | **32,611** | **9,268** | **211** | **74,141** |
| Profit for the year | - | - | - | 13,658 | - | (7) | 13,651 |
| Other comprehensive income for the year | - | - | - | - | (2,019) | - | (2,019) |
| Total comprehensive income for the year | - | - | - | 13,658 | (2,019) | (7) | 11,632 |
| Increase of Share capital and Share premium | - | 8,000 | - | - | - | - | 8,000 |
| Dividends paid (Note: 14) | - | - | - | (13,320) | - | - | (13,320) |
| **At 31 December 2013** | **5,855** | **15,509** | **18,687** | **32,949** | **7,249** | **204** | **80,453** |

[(1)] The statutory reserve represents accumulated transfers from retained earnings in compliance with the Czech Commercial Code. This reserve is not distributable and could be used only for compensation of losses incurred.

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

# *CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Profit before tax | | 16,071 | 17,539 |
| Adjustments for: | | | |
| Change in operating assets | 33 | (74,300) | (11,493) |
| Change in operating liabilities | 33 | 80,661 | (5,708) |
| Non-cash items included in profit before tax | 33 | (975) | 3,611 |
| Net gains from investing activities | | (43) | (1,457) |
| Income tax paid | | (2,435) | (1,374) |
| **Net cash flows from operating activities** | | **18,979** | **1,118** |
| **INVESTING ACTIVITIES** | | | |
| Purchase of held-to-maturity investments | | (3,260) | (3,164) |
| Maturity / disposal of investment securities | | 7,111 | 2,858 |
| Purchase of property, equipment and intangible assets | | (1,858) | (1,703) |
| Proceeds from disposal of property, equipment, intangible assets and assets held-for-sale | | 777 | 654 |
| Purchase of investment property | | (7) | - |
| Dividends from associates | | 54 | 481 |
| Proceeds from disposal of subsidiary, associate and joint venture companies | | - | 2,269 |
| **Net cash flows from investing activities** | | **2,817** | **1,395** |
| **FINANCING ACTIVITIES** | | | |
| Repayment of bonds | | - | (1,000) |
| Repayment of subordinated debt | | (8,000) | (4,000) |
| Issue of bonds | | 2,559 | 5,166 |
| Increase of share capital and share premium | | 8,000 | - |
| Dividends paid | 14 | (13,320) | (6,596) |
| **Net cash flows used in financing activities** | | **(10,761)** | **(6,430)** |
| **Net increase / (decrease) in cash and cash equivalents** | | **11,035** | **(3,917)** |
| Cash and cash equivalents at the beginning of the year | 33 | 10,680 | 14,597 |
| Net increase / (decrease) in cash and cash equivalents | | 11,035 | (3,917) |
| **Cash and cash equivalents at the end of the year** | 33 | **21,715** | **10,680** |
| **Additional information** | | | |
| Interest paid | | (6,739) | (8,092) |
| Interest received | | 31,410 | 34,480 |
| Dividends received (other than from associates) | | 10 | 26 |

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

# *NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013*

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).

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 (CZKm), 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 Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. 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 included in the Group consolidation are accounted for using proportionate consolidation. A venturer's share of assets, liabilities, income and expenses in the joint venture is combined with those of the venturer on a line-by-line basis. A joint venture exists when two or more venturers are bound by a contractual arrangement whereby joint control is established.

## *2.2 Significant accounting judgements and estimates*

While applying the Group accounting policies, the management has used its judgements 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**

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**

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**

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.

**Classification of leases**

Classification of leases into either finance leases or operating leases is based on the extent to which the risks and rewards from the asset ownership have been transferred from a lessor to a lessee. If a substantial number of all the risks and rewards incidental to ownership have been transferred to the lessee the lease is classified as a finance lease. Management judgement is needed to assess the extent to which the risks and rewards have been transferred.

**Deferred tax assets**

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

**Provisions**

Provisions are recognised when a current obligation exists as a result of past events. It is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate of the amount will be made. Judgements are applied to evaluate whether the current obligation exists taking into account all available evidence and whether the event is more likely to occur than not. Estimates of the amount of the obligation also require management judgement.

## *2.3 Changes in accounting policies*

**Effective from 1 January 2013**

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.

**IFRS 1 Government Loans (Amendments)** is effective for periods beginning on or after 1 January 2013. The amendments add an exception to the retrospective application of IFRSs to require that first-time adopters apply the requirements in IAS 20 prospectively to government loans existing at the date of transition to IFRSs.

**IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments)** is effective for periods beginning on or after 1 January 2013. The amendment presents new required disclosures to include information that will enable users of an entity's financial statements to evaluate the effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position.

**IFRS 13 Fair Value Measurement** is effective for periods beginning on or after 1 January 2013. The standard provides guidance on how to measure the fair value of financial and non-financial assets and liabilities. The standard does not have any significant effect on the statement of financial position or income but has increased the amount of information disclosed in the notes.

**IAS 1 Presentation of Items of Other Comprehensive Income (Amendments)** is effective for annual periods beginning on or after 1 July 2012. The amendments change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items which will never be reclassified. The option is retained to present profit or loss and OCI either in a single continuous statement or in two separate, but consecutive, statements.

**IAS 19 Employee Benefits (Revision)** is effective for periods beginning on or after 1 January 2013. The main changes within the revised standard relate to the accounting treatment of the category of post-employment benefits - defined benefit plans:

- The corridor mechanism for pension plans is abolished and all changes in the value of defined benefit plans will be recognised as they occur
- The presentation options of actuarial results are eliminated
- The level of disclosures has increased

Other smaller changes to the short-term employee benefits and termination benefits and a number of minor clarifications and re-wording are included in the revised standard.

**Improvements to IFRSs**, issued in May 2012 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard. None of these have a significant impact on the accounting policies, financial position or performance of the Group.

**Effective after 1 January 2013**

The following standards, amendments and interpretations have been issued and are effective after 1 January 2013. 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 (2013)** is available for application, however, it does not set the mandatory effective date. The uncertainty is due to the fact that the project on impairment of financial assets is still in progress. The previous effective date of 2015 has been removed from the standard until the impairment phase of the project is completed. The standard has not been endorsed by the European Commission to date.

The project to replace the current IAS 39 Financial Instruments: Recognition and Measurement has been divided into three phases. The first phase focuses on classification and measurement of financial instruments.

The new standard has reduced the number of asset measurement categories from four to two. Debt instruments are classified at amortised cost or fair value on the basis of both:

- The entity's business model for managing financial assets; and
- The contractual cash flow characteristics of the financial asset.

Debt instruments may be measured at amortised cost if both conditions are met:

- The 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.

Reclassifications between the two asset categories are required when the entity changes its business model. IFRS 9 retains a fair value option. At initial recognition entities can elect to measure financial assets at fair value, although they would otherwise qualify for amortised cost measurement. IFRS 9 removes the separation of embedded derivatives and the instrument is assessed in its entirety as to whether it fulfills the above two conditions.

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

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 caused by changes in its own credit quality are recognised in other comprehensive income rather than in the statement of income. The entity can choose to apply this policy without applying other IFRS 9 requirements at the same time. Original requirements related to derecognition of financial assets and financial liabilities are carried forward unchanged from IAS 39 to IFRS 9.

The standard will have a significant impact on the Group financial statements, however due to the uncertainties about the second, impairment phase, and the macro hedging project, the impact of the IFRS 9 is not reasonably estimable.

The third phase, micro hedge accounting, aligns more closely the hedge accounting and risk management. In practice, more hedging strategies used for risk management will qualify for hedge accounting. The three types of hedge accounting (cash flow, fair value and net investment hedges) have been carried forward from IAS 39. The hedging relationship has to be effective at inception and on an ongoing basis and will be subject to a qualitative or quantitative forward-looking effectiveness assessment. The hedge effectiveness range of 80-125% is replaced by an objective-based test. If the hedging relationship meets risk management objectives it cannot be voluntarily terminated, rather, the quantities of hedged item or a hedging instrument have to be adjusted and hedged ratio rebalanced to comply with hedge effectiveness requirement.

Non-derivative financial assets and liabilities with fair value through profit or loss can be designated as hedging instruments in hedging relationships of any risk, not just foreign currency risk. They have to be designated in their entirety or as a proportion of their nominal amount.

The hedge accounting model extends the eligibility of risk components to include non-financial items, provided the component is separately identifiable and can be reliably measured. The current status of the third phase of IFRS 9 is exposure draft.

**IFRS 10 Consolidated Financial Statements** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard replaces the part relating to the consolidated portion of IAS 27 Consolidated and Separate Financial Statements. A new definition of control is included and a single control model that applies to all entities is introduced.

**IFRS 11 Joint Arrangements** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard replaces IAS 31 Interests in Joint Ventures and SIC 13 Jointly-controlled Entities – Non-monetary Contributions by Venturers. The standard will have an impact on the consolidated financial statements of the Group. The proportionate method of consolidation will be disallowed by the new standard. Each line of financial statements will be reduced by amounts contributed by Českomoravská stavební spořitelna, a.s. (ČMSS) and the resulting interest in the joint venture will be presented in one line in the caption Investment in associates and joint ventures in the statement of financial position. In the statement of income, (respectively statement of other comprehensive income), one line item will be presented in the caption Share of profit of associates and joint ventures, and Share of other comprehensive income of associates and joint ventures respectively.

**IFRS 12 Disclosure of Interest in Other Entities** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard includes all of the disclosure requirements that were included in IAS 27, IAS 28 and IAS 31. The entity will be required to disclose judgements made to determine whether it controls an entity.

**IFRS 10, 11, 12 Transition Guidance (Amendments)** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The amendments change the transition guidance to provide further relief from full retrospective application. The amendments clarify that an entity is not required to make adjustments to the previous accounting for its involvement with entities if the consolidation conclusion reached at the date of initial application is the same when applying IAS 27/SIC-12 and when applying IFRS 10.

**Investment Entities (Amendments to IFRS 10, 12 and IAS 27)** is effective for periods beginning on or after 1 January 2014. The amendments define an investment entity and introduce an exception to consolidating particular subsidiaries for investment entities. These amendments require an investment entity to measure those subsidiaries at fair value through profit or loss in its consolidated and separate financial statements. The amendments also introduce new disclosure requirements for investment entities in IFRS 12 and IAS 27.

**IAS 27 Separate Financial Statements (Amendment)** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

**IAS 28 Investments in Associates and Joint Ventures (Amendment)** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

**IAS 32 Offsetting Financial Assets and Financial Liabilities (Amendments)** is effective for periods beginning on or after 1 January 2014. These amendments clarify the meaning of “currently has a legally enforceable right to set-off” and also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous.

**Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)** is effective for periods beginning on or after 1 January 2014. The amendments provide relief from discontinuing hedge accounting when the novation of a derivative designated as a hedging instrument meets certain criteria. Similar relief will be included in IFRS 9 *Financial Instruments*.

**Recoverable Amount Disclosures for Non-financial Assets (Amendments to IAS 36)** is effective for periods beginning on or after 1 January 2014. The amendment clarifies the disclosure requirements of IAS 36 in relation to the standard IFRS 13 *Fair value measurement.*

**Defined Benefit Plans: Employees Contributions (Amendments to IAS 19)** is effective for periods beginning on or after 1 July 2014. The amendment brings clarification of the accounting requirements for contributions from employees or third parties to a defined benefit plan. It specifies conditions under which the contributions can be accounted for as a reduction of service costs.

**IFRIC 21 Levies** is effective for periods beginning on or after 1 January 2014. IFRIC 21 provides guidance on when to recognise a liability for a levy imposed by a government, both for levies that are accounted for in accordance with IAS 37 and those where the timing and amount of the levy is certain. IFRIC 21 identifies the obligating event for the recognition of a liability as the activity that triggers the payment of the levy in accordance with the relevant legislation.

**Improvements to IFRSs**, issued in December 2013 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard.

## *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*

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) 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 amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction. 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 come 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.

*(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) 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 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 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.

*(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 (excluding mandatory minimum reserves), loans and advances (measured at both amortised cost and at fair value) to credit institutions and financial liabilities at amortised cost to credit institutions.

**(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**

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.

Investments in associates are accounted for using the equity method. The Group's share of associates' post-acquisition profits or losses is recognised in the statement of income, and its share of post-acquisition OCI is recognised through OCI in Retained earnings or in the Available-for-sale reserve.

**(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 purchase 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.

**(18) Intangible assets**

Intangible assets include software, licences, customer relationship and other intangible assets.

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.

Amortisation of the 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:

| | |
|---|---|
| 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 recognised 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 and 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) Taxes**

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 Commercial Code and its use is limited by this legislation and the Articles of association or Statutes. The fund is not available for distribution to shareholders.

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 26 companies. Ownership of the Group (%) in significant companies was as follows:

| Name | Abbreviation | Country of incorporation | % 2013 | % 2012 |
|---|---|---|---|---|
| **Subsidiaries** | | | | |
| 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 fond Stabilita, a.s., a member of the ČSOB group | ČSOB PF Stabilita | Czech Republic | - | 100.00 |
| ČSOB Penzijní společnost, a. s., a member of the ČSOB group | ČSOB PS | Czech Republic | 100.00 | - |
| Transformovaný fond Stabilita ČSOB Penzijní společnosti, a.s., a member of the ČSOB Group | Transformed fund | Czech Republic | 100.00 | - |
| ČSOB Property fund, closed-ended investment fund, a.s., a member of the ČSOB group | 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 |
| Property LM, s.r.o. | Property LM | Slovak Republic | 61.61 | 61.61 |
| Property Skalica, s.r.o. | Property Skalica | Slovak Republic | 61.61 | 61.61 |
| **Joint venture** | | | | |
| Českomoravská stavební spořitelna, a.s. | ČMSS | Czech Republic | 55.00 | 55.00 |
| **Associate** | | | | |
| ČSOB Asset Management, a.s., investment company | ČSOB AM/IS | 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 1 January 2013, new legislation introducing reforms to the pension fund system within the Czech Republic became effective. Accordingly, the net assets of the ČSOB PF Stabilita were split to the group of net assets of pension fund shareholders forming the pension fund management company ČSOB Penzijní společnost, a. s., a member of the ČSOB group and to the group of net assets of pension scheme participants forming the Transformed fund (as a part of Pillar III), which is closed to new participants. ČSOB PS is responsible for management of the Transformed fund. This company is entitled to up to 15% of the profits of the Transformed fund in addition to a regular assets management fee and needs to guarantee the positive results and equity position of the Transformed fund. As a result, the Group retains control over the Transformed fund and continues to consolidate it.

In November 2012, ČSOB sold 24.76% of its ownership in ČSOB Pojišťovna to KBC Insurance NV. The sale did not affect the significant influence of the Bank over the ČSOB Pojišťovna as 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 from now on. Thus, ČSOB Pojišťovna is still assessed to be an associated company of the Bank (Notes: 9, 19, 24, 38).

Starting in January 2012, as a result of the merger of ČSOB Investiční společnost, a.s., a member of the ČSOB group and ČSOB Asset Management, a.s., a member of the ČSOB group and the effective date of the registration, the Group effectively lost control over the merged ČSOB AM/IS and started to account for the entity using the equity method going forward. The advance payment received from the pre-merger sale in the amount of CZK 149 m was recognised in Other net income in the consolidated statement of income for the year ended 31 December 2012, when the control was lost. In November 2012, the Group sold 21 shares of ČSOB AM/IS to KBC Participations Renta C, SA to achieve a target share of the Group on the equity of ČSOB AM/IS of 40.08%. The realised gain on the sale amounted to CZK 75 m (Notes: 9, 19, 24, 38).

In May 2012, ČSOB Investment Banking Services, a.s., a member of the ČSOB group was renamed to ČSOB Advisory, a.s. In October 2012, Auxilium merged with ČSOB Advisory. ČSOB Advisory being the successor company.

In 2012, the indirect participation of the Group in ČSOB Property fund, Property LM, Property Skalica and Merrion Properties decreased as a result of the Bank´s decision to sell the part of its ownership in ČSOB Pojišťovna and ČSOB AM/IS. The decrease was partially compensated by the Bank's decision to realize a buyout of shares.

Based on the Agreement on the exercise of voting rights, the Group is entitled to excercise 50.82% of the voting rights in ČSOB Leasing, since the remaining 49.18% of the voting rights were transferred to the KBC Lease Holding NV.

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, Merrion Properties, Property LM and Property Skalica.

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 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:**

**ČSOB Retail / SME:** Private individuals and entrepreneurs and companies with a turnover of less than CZK 300 m. This segment contains customers' deposits, consumer loans, overdrafts, credit cards facilities, funds transfer facilities and other transactions and balances with retail and SME customers. Margin income from operations with retail and SME 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).

**ČSOB Corporate:** Companies with a turnover greater than CZK 300 m and financial institutions. This segment contains customers' deposits, loans, overdrafts, credit cards facilities, funds transfer facilities and other transactions and balances with corporate customers. Margin income from the operations with corporate 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).

**ČSOB 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 consists of the result of operations of all CSOB Bank subsidiaries. It contains mortgages, building savings, building saving loans, pension funds, leasing, mutual funds, asset management and factoring. The specialised banking segment started to be reported as a separate segment as from 2013. Comparative amounts of segment reporting information for 2012 have been reclassified.

**Group Centre:** The Group Centre segment consists of the Group's yield on real equity consisting of an interest charge on capital provided to subsidiaries which are a part of the Specialised banking segment, the results of the reinvestment of free equity of ČSOB, Asset Liability Management (ALM), income and expenses not directly attributable to other segments and eliminations. In 2012, net gains on the disposal of participations in ČSOB Pojišťovna and ČSOB AM/IS are included.

**Segment reporting information by customer segments for 2013**

| (CZKm) | ČSOB Retail / SME | ČSOB Corporate | ČSOB Financial markets | Specialised banking | Group Centre | **Total** |
|---|---|---|---|---|---|---|
| ***Statement of income*** | | | | | | |
| Net interest income | 11,297 | 2,827 | 627 | 6,737 | 2,577 | **24,065** |
| Net fee and commission income | 3,811 | 876 | 388 | 1,103 | (195) | **5,983** |
| Dividend income | - | - | - | 4 | 6 | **10** |
| Net gains / (losses) from financial instruments at fair value through profit or loss | 1,177 | 798 | 15 | (83) | 139 | **2,046** |
| Net realised gains on available-for-sale financial assets | - | - | - | 56 | 352 | **408** |
| Other net income | 176 | 14 | - | 47 | 248 | **485** |
| **Operating income** | **16,461** | **4,515** | **1,030** | **7,864** | **3,127** | **32,997** |
| *of which:* | | | | | | |
| *External operating income* | *7,983* | *4,173* | *1,030* | *11,754* | *8,057* | *32,997* |
| *Internal operating income* | *8,478* | *342* | - | *(3,890)* | *(4,930)* | - |
| Depreciation and amortisation | (76) | - | - | (382) | (374) | **(832)** |
| Other operating expenses | (10,229) | (1,475) | (326) | (2,373) | (296) | **(14,699)** |
| **Operating expenses** | **(10,305)** | **(1,475)** | **(326)** | **(2,755)** | **(670)** | **(15,531)** |
| Impairment losses - additions | (1,416) | (367) | - | (1,480) | (172) | **(3,435)** |
| Impairment losses - reversals | 642 | 411 | - | 515 | 420 | **1,988** |
| **Impairment losses** | **(774)** | **44** | **-** | **(965)** | **248** | **(1,447)** |
| Share of profit of associates | - | - | - | - | 52 | **52** |
| **Profit before tax** | **5,382** | **3,084** | **704** | **4,144** | **2,757** | **16,071** |
| Income tax benefit / (expense) | (1,024) | (586) | (134) | (830) | 154 | **(2,420)** |
| **Segment profit** | **4,358** | **2,498** | **570** | **3,314** | **2,911** | **13,651** |
| **Attributable to:** | | | | | | |
| Owners of the parent | 4,358 | 2,498 | 570 | 3,314 | 2,918 | **13,658** |
| Non-controlling interest | - | - | - | - | (7) | **(7)** |
| ***Assets and liabilities*** | | | | | | |
| Segment assets | 92,488 | 122,395 | 238,850 | 338,051 | 242,728 | **1,034,512** |
| Investment in associates | - | - | - | - | 124 | **124** |
| Non-current assets held-for-sale | - | - | - | 174 | 20 | **194** |
| **Total assets** | **92,488** | **122,395** | **238,850** | **338,225** | **242,872** | **1,034,830** |
| **Total liabilities** | **454,330** | **105,810** | **192,331** | **135,601** | **66,305** | **954,377** |
| **Capital expenditure** | **86** | **2** | **-** | **1,411** | **252** | **1,751** |

**Segment reporting information by customer segments for 2012**

| (CZKm) | Bank Retail / SME | Bank Corporate | Bank Financial markets | Specialised banking | Group Centre | **Total** |
|---|---|---|---|---|---|---|
| ***Statement of income*** | | | | | | |
| Net interest income | 11,592 | 2,709 | 754 | 6,948 | 2,967 | **24,970** |
| Net fee and commission income | 3,724 | 920 | 301 | 654 | (94) | **5,505** |
| Dividend income | 1 | - | - | 20 | 5 | **26** |
| Net gains / (losses) from financial instruments at fair value through profit or loss | 1,088 | 773 | 626 | 136 | (308) | **2,315** |
| Net realised gains on available-for-sale financial assets | - | - | - | 265 | (139) | **126** |
| Other net income | 174 | 5 | (1) | 236 | 1,659 | **2,073** |
| **Operating income** | **16,579** | **4,407** | **1,680** | **8,259** | **4,090** | **35,015** |
| *of which:* | | | | | | |
| *External operating income* | *7,155* | *4,127* | *1,680* | *12,881* | *9,172* | *35,015* |
| *Internal operating income* | *9,424* | *280* | *-* | *(4,622)* | *(5,082)* | *-* |
| Depreciation and amortisation | (104) | (1) | - | (353) | (398) | **(856)** |
| Other operating expenses | (10,443) | (1,466) | (322) | (2,385) | (615) | **(15,231)** |
| **Operating expenses** | **(10,547)** | **(1,467)** | **(322)** | **(2,738)** | **(1,013)** | **(16,087)** |
| Impairment losses - additions | (1,408) | (492) | - | (1,654) | (244) | **(3,798)** |
| Impairment losses - reversals | 605 | 718 | - | 546 | 345 | **2,214** |
| **Impairment losses** | **(803)** | **226** | **-** | **(1,108)** | **101** | **(1,584)** |
| Share of profit of associates | - | - | - | - | 195 | **195** |
| **Profit before tax** | **5,229** | **3,166** | **1,358** | **4,413** | **3,373** | **17,539** |
| Income tax benefit / (expense) | (969) | (602) | (258) | (866) | 437 | **(2,258)** |
| **Segment profit** | **4,260** | **2,564** | **1,100** | **3,547** | **3,810** | **15,281** |
| **Attributable to:** | | | | | | |
| Owners of the parent | 4,260 | 2,564 | 1,100 | 3,547 | 3,820 | **15,291** |
| Non-controlling interest | - | - | - | - | (10) | **(10)** |
| ***Assets and liabilities*** | | | | | | |
| Segment assets | 89,417 | 107,904 | 169,325 | 317,880 | 252,437 | **936,963** |
| Investment in associates | - | - | - | - | 126 | **126** |
| Non-current assets held-for-sale | - | - | - | 85 | - | **85** |
| **Total assets** | **89,417** | **107,904** | **169,325** | **317,965** | **252,563** | **937,174** |
| **Total liabilities** | **436,292** | **99,877** | **134,356** | **131,948** | **60,560** | **863,033** |
| **Capital expenditure** | **246** | **4** | **-** | **982** | **302** | **1,534** |

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) | 2013 | 2012 |
|---|---|---|
| Cash balances with central banks | 12 | 141 |
| Loans and receivables | | |
| Credit institutions | 403 | 462 |
| Other than credit institutions | 19,636 | 20,877 |
| Available-for-sale financial assets | 2,505 | 2,880 |
| Held-to-maturity investments | 5,917 | 5,844 |
| Financial assets held for trading (Note: 8) | 770 | 1,453 |
| Financial assets designated at fair value through profit or loss (Note: 8) | 262 | 344 |
| Derivatives used as economic hedges (Note: 8) | 92 | 209 |
| Derivatives used for hedging (Note: 8) | 632 | 487 |
| | **30,229** | **32,697** |

## 6. INTEREST EXPENSE

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Financial liabilities at amortised cost | | |
| Central banks | 3 | 6 |
| Credit institutions | 184 | 243 |
| Other than credit institutions | 4,208 | 5,188 |
| Debt instruments in issue | 397 | 430 |
| Subordinated liabilities | 76 | 173 |
| Discount amortisation on other provisions (Note: 29) | 3 | 3 |
| Financial liabilities held for trading (Note: 8) | 162 | 663 |
| Derivatives used as economic hedges (Note: 8) | 407 | 551 |
| Derivatives used for hedging (Note: 8) | 724 | 470 |
| | **6,164** | **7,727** |

## 7. NET FEE AND COMMISSION INCOME

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Fee and commission income** | | |
| Payment services | 5,217 | 5,094 |
| Administration of credits | 1,938 | 2,002 |
| Collective investments | 635 | 406 |
| Securities | 145 | 63 |
| Custody | 144 | 157 |
| Asset management | 61 | 73 |
| Other | 981 | 952 |
| | **9,121** | **8,747** |
| **Fee and commission expense** | | |
| Payment services | 1,185 | 960 |
| Retail service fees | 1,101 | 1,045 |
| Commissions to agents | 298 | 669 |
| Other | 554 | 568 |
| | **3,138** | **3,242** |
| **Net fee and commission income** | **5,983** | **5,505** |

## 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) | 2013 | 2012 |
|---|---|---|
| **Net gains from financial instruments at fair value through profit or loss and foreign exchange- as reported** | **2,046** | **2,315** |
| Net interest income (Notes: 5, 6) | 463 | 809 |
| | **2,509** | **3,124** |
| **Financial instruments held for trading and derivatives used for hedging** | | |
| Interest rate contracts | 293 | 537 |
| Foreign exchange | (6,060) | 3,005 |
| Equity contracts | - | 20 |
| Commodity contracts | 14 | 16 |
| | (5,753) | 3,578 |
| **Financial instruments designated at fair value through profit or loss** | | |
| Financial assets designated at fair value through profit or loss | 300 | 489 |
| Foreign exchange differences | 7,962 | (943) |
| **Financial instruments at fair value through profit or loss and foreign exchange** | **2,509** | **3,124** |

## 9. OTHER NET INCOME

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Net operating leasing and rental income | 278 | 392 |
| Services provided to the parent and to entities under common control | 159 | 198 |
| Other services provided by ČSOB Leasing | 54 | 54 |
| Net gain on disposal of property and equipment | 33 | 30 |
| Net gain / (loss) on disposal of Held-to-maturity investments | 10 | (24) |
| Net gain from the sale of ČSOB Pojišťovna (Note: 3) | - | 1,230 |
| Net gain from the sale of ČSOB AM/IS (Note: 3) | - | 224 |
| Net (increase) / decrease in provisions for legal issues | (1) | 19 |
| Contributions to pension fund clients | (519) | (519) |
| Other | 471 | 469 |
| | **485** | **2,073** |

## 10. STAFF EXPENSES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Wages and salaries | 5,009 | 5,112 |
| Salaries and other short-term benefits of senior management | 91 | 69 |
| Social security charges | 1,623 | 1,523 |
| Pension and similar expense | 146 | 157 |
| Additions and reversals of provisions for Restructuring programme (Note: 29) | (1) | 203 |
| Other | 162 | 158 |
| | **7,030** | **7,222** |

**Management bonus scheme**

Included within Salaries and other short-term benefits of senior 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.

Only the Chairman of the Supervisory Board is remunerated for his membership 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. 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 senior management) with a voluntary defined contribution retirement scheme. Participating employees can contribute 1% or 2% of their salaries mainly to ČSOB PF Stabilita, a wholly-owned subsidiary of ČSOB, and to other pension funds 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. The contributions are from 1 January 2013 as a part of pension reform sent to the newly formed Transformed fund or participation funds managed by ČSOB PS or other pension companies

**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 month's 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 6 to 24 monthly salaries as termination benefits (number of months depends on individual contracts). During 2013 and 2012, no such compensation was paid out.

## 11. GENERAL ADMINISTRATIVE EXPENSES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Rental expenses on information technologies – minimum lease payments | 1,638 | 1,606 |
| Information technologies | 1,291 | 1,303 |
| Deposit insurance premium and contribution to the Securities Traders Guarantee Fund | 881 | 855 |
| Marketing | 698 | 807 |
| Other building expenses | 556 | 546 |
| Rental expenses on land and buildings - minimum lease payments | 516 | 535 |
| Professional fees | 437 | 469 |
| Communication | 358 | 401 |
| Retail service fees | 174 | 140 |
| Administration | 154 | 180 |
| Travel and transportation | 130 | 125 |
| Payment cards and electronic banking | 111 | 234 |
| Training | 83 | 120 |
| Car expenses | 39 | 47 |
| Insurance | 39 | 37 |
| Other | 564 | 604 |
| | **7,669** | **8,009** |

## 12. IMPAIRMENT LOSSES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Impairment of loans and receivables (Notes: 18, 33) | (1,378) | (1,631) |
| Provisions for loan commitments and guarantees (Notes: 29, 33) | 19 | 57 |
| Impairment of available for sale assets (Notes: 17, 31, 33) | - | (26) |
| Impairment of property, plant and equipment (Notes: 22, 33) | (41) | (8) |
| Impairment of investment property (Notes: 21, 33) | (9) | (50) |
| Impairment of goodwill (Notes: 23, 33) | - | (193) |
| Impairment of intangible asets (Notes: 23, 33) | (33) | - |
| Impairment of non-current assets held-for-sale (Notes: 24, 33) | (5) | (21) |
| Impairment of other assets (Note: 33) | - | 288 |
| | **(1,447)** | **(1,584)** |

## 13. TAXATION

The components of income tax expense for the years ended 31 December 2013 and 2012 are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Current tax expense | 2,522 | 2,116 |
| Net provisions for tax disputes | - | (199) |
| Previous year over accrual of current tax | (39) | (475) |
| Deferred tax (benefit) / expense relating to the origination and reversal of temporary differences | (63) | 816 |
| | **2,420** | **2,258** |

A reconciliation between the tax expense and the accounting profit multiplied by the domestic tax rate for the years ended 31 December 2013 and 2012 is as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Profit before taxation | 16,071 | 17,539 |
| Applicable tax rates | 19% | 19% |
| | | |
| Taxation at applicable tax rates | 3,054 | 3,332 |
| Net provisions for tax disputes | - | (199) |
| Previous year over accrual of current tax | (39) | (475) |
| Previous year under accrual of deferred tax | - | 610 |
| Tax effect of non-taxable income | (884) | (1,428) |
| Tax effect of non-deductible expenses | 289 | 410 |
| Other | - | 8 |
| | **2,420** | **2,258** |

The applicable tax rate for 2013 was 19% (2012: 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) | 2013 | 2012 |
|---|---|---|
| **At 1 January** | **(2,444)** | **(600)** |
| Statement of income | 63 | (816) |
| Available-for-sale securities (Note: 31) | | |
| Fair value remeasurement | 82 | (534) |
| Transfer to net profit | 96 | (26) |
| Cash-flow hedges (Note: 31) | | |
| Fair value remeasurement | 201 | (446) |
| Transfer to net profit | 41 | (21) |
| Exchange differences | - | (1) |
| **At 31 December** | **(1,961)** | **(2,444)** |

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

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Deferred tax asset** | | |
| Accelerated tax depreciation | 50 | 44 |
| Allowances for credit losses | 42 | 42 |
| Provisions | 2 | 1 |
| Available-for-sale securities | (3) | (3) |
| Other temporary differences | 5 | 4 |
| | **96** | **88** |
| **Deferred tax liability** | | |
| Available-for-sale securities | 820 | 1,227 |
| Cash-flow hedging derivatives | 646 | 897 |
| Accelerated tax depreciation | 486 | 626 |
| Amortisation of goodwill | 369 | 338 |
| Initial fee expense | 230 | 291 |
| Held-to-maturity investments - bonds reclassified from Available-for-sale securities (Note: 17) | 208 | - |
| Finance lease valuation | 108 | 117 |
| Unused tax losses applicable in the next periods | - | (81) |
| Impairment losses on financial investments | (26) | (26) |
| Interest rate bonus | (52) | (76) |
| Revaluation of financial assets and liabilities at fair value through profit or loss | (59) | (93) |
| Legal claims | (72) | (131) |
| Allowances for credit losses | (130) | (176) |
| Provisions | (142) | (140) |
| Employee benefits | (279) | (195) |
| Other temporary differences | (50) | (46) |
| | **2,057** | **2,532** |

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

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Accelerated tax depreciation | 146 | 195 |
| Employee benefits | 84 | (52) |
| Initial fee income | 61 | (59) |
| Available-for-sale securities | 28 | 36 |
| Finance lease valuation | 9 | 54 |
| Provisions | 3 | 4 |
| Impairment losses on financial investments | - | (638) |
| Interest rate bonus | (24) | (1) |
| Amortisation of goodwill | (31) | (36) |
| Revaluation of financial assets and liabilities at fair value through profit or loss | (34) | 16 |
| Allowances for credit losses | (46) | (111) |
| Legal claims | (59) | (3) |
| Unused tax losses applicable in the next periods | (81) | (217) |
| Other temporary differences | 7 | (4) |
| | **63** | **(816)** |

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 2013 has not been taken before the date of issue of the financial statements.

Based on a sole shareholder decision from 28 June 2013, a dividend of CZK 45.50 per share was paid for 2012, representing a total dividend of CZK 13,320 m.

Based on a sole shareholder decision from 26 June 2012, a dividend of CZK 22.53 per share was paid for 2011, representing a total dividend of CZK 6,596 m.

## 15. CASH AND BALANCES WITH CENTRAL BANKS

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Cash (Note: 33) | 9,939 | 9,053 |
| Mandatory minimum reserves (Notes: 34, 40.2) | 9,473 | 9,859 |
| Reverse repo transactions (Notes: 33, 34, 36, 40.2) | 32,000 | 7,500 |
| Other balances with central banks (Notes: 33, 34, 40.2) | 3,624 | 1,881 |
| | **55,036** | **28,293** |

Mandatory minimum reserves are not available for use in the Group’s day-to-day operations.

The Czech National Bank (CNB) pays interest on the mandatory minimum reserve balances based on the official CNB two-week repo rate.

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

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Financial assets held for trading** | | |
| Loans and advances | | |
| Reverse repo transactions (Note: 36) | 139,864 | 95,819 |
| Money market placements | 19,567 | 15,966 |
| Debt instruments | | |
| Central government | 27,878 | 29,505 |
| Non credit institutions | 8 | 21 |
| Credit institutions | 5,190 | 4,950 |
| Corporate | 329 | 879 |
| Derivative contracts (Note: 20) | | |
| Trading derivatives | 11,508 | 13,668 |
| Derivatives used as economic hedges | 385 | 1,457 |
| | **204,729** | **162,265** |
| **Financial assets designated at fair value through profit or loss** | | |
| Debt instruments | | |
| Central government | 1,396 | 1,312 |
| Non credit institutions | 425 | 398 |
| Credit institutions | 5,646 | 5,642 |
| | **7,467** | **7,352** |
| **Financial assets at fair value through profit or loss** | **212,196** | **169,617** |

Included within Financial assets at fair value through profit or loss are debt securities of CZK 9,163 m (2012: CZK 2,407 m) pledged as collateral in repo transactions.

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 bases.

## 17. FINANCIAL INVESTMENTS

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Available-for-sale financial assets** | | |
| Debt securities | | |
| Central government | 56,365 | 64,297 |
| Non credit institutions | 846 | - |
| Credit institutions | 23,241 | 25,042 |
| Corporate | 2,179 | 2,012 |
| Equity securities | | |
| Corporate | 709 | 553 |
| | **83,340** | **91,904** |
| **Held-to-maturity investments** | | |
| Debt securities | | |
| Central government | 149,335 | 136,137 |
| Non credit institutions | - | 519 |
| Credit institutions | 1,417 | 1,682 |
| Corporate | 192 | 99 |
| | **150,944** | **138,437** |
| **Financial investments** | **234,284** | **230,341** |

Included within Financial investments are debt securities of CZK 31,501 m (2012: CZK 8,307 m) pledged as collateral in repo transactions and debt securities of CZK 5,330 m (2012: CZK 1,766 m) pledged as collateral of term deposits and financial guarantees.

In February 2012, an agreement on the key terms of the voluntary exchange of Greek government bonds held by the private sector was reached in the European Union. Based on the decision of the Group to accede to the agreement, the Group derecognised the entire amount of old Greek bonds and realised a loss in the amount of CZK 412 m reported under Net realised gains on available-for-sale financial assets in the statement of income.

Just after the derecognition of the old Greek bonds, new financial instruments were recognised along with the key terms of the agreement. 15% of the principal of the old Greek bonds was exchanged for short-term securities issued by the European Financial Stability Facility (EFSF) and 31.5% was converted into 20 new tranches of coupon bonds issued by the Greek government and Greek GDP-linked securities. Interest income, which was accrued on the old Greek bonds but was not paid by the date of the exchange, was replaced by short-term EFSF notes.

On 30 March 2012, the new debt instruments in the total carrying amount of CZK 1,115 m were sold to KBC Credit Investments NV. No debt instruments issued by Greek government were held by the Group as at 31 December 2012 (Note: 38).

Due to a deterioration in the issuers' credibility, the Group decided to gradually sell the portfolio of bonds issued by the Italian and Spanish government classified as Held-to-maturity investments. Following the decision, Italian bonds in the amount of CZK 975 m were sold in the end of 2011. The remaining position of the Italian and Spanish sovereign bonds in the total amount of CZK 1,499 m was sold in 2012. All these sales are considered by the Group as insignificant in relation to the entire Held-to-maturity portfolio.

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; 2011: CZK 471 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:

| (CZKm) | 2013 |
|---|---|
| Carrying value | 14,001 |
| Fair value | 14,675 |
| Net gain (before tax) that would have been recognised during 2013 in the Statement of comprehensive income after the date of reclassification if the Group had not reclassified the assets | 674 |
| Interest income (before tax) recorded on reclassified assets in 2013 after date of reclassification | 256 |
| Expected undiscounted cash recoveries, as assessed at the date of reclassification | 15,135 |
| Anticipated average EIR over the remaining life of the assets | 3.5% |

The following table shows a reconciliation of the cumulative impairment losses on financial investments for 2012 and 2013:

| | Available-for-sale financial assets | | Held-to maturity investments | Total |
|---|---|---|---|---|
| (CZKm) | Debt securities | Equity securities | Debt securities | |
| **At 1 January 2012** | **3,317** | **450** | **-** | **3,767** |
| Increase (Note: 12) | - | 26 | - | 26 |
| Utilisation | (3,162) | (298) | - | (3,460) |
| Foreign currency translation | (155) | - | - | (155) |
| **At 31 December 2012** | **-** | **178** | **-** | **178** |
| Increase (Note: 12) | - | - | - | - |
| Utilisation | - | (37) | - | (37) |
| Foreign currency translation | - | - | - | - |
| **At 31 December 2013** | **-** | **141** | **-** | **141** |

## 18. LOANS AND RECEIVABLES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Analysed by category of borrower** | | |
| Central government | 466 | 293 |
| Non credit institutions | 8,022 | 7,675 |
| Credit institutions | 28,161 | 24,461 |
| Other legal entities | 167,645 | 158,065 |
| Private individuals | 316,934 | 301,217 |
| Gross loans | 521,228 | 491,711 |
| Allowance for impairment losses | (11,972) | (12,195) |
| | **509,256** | **479,516** |

Of which finance lease receivables may be analysed as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Gross investment in finance leases, receivable** | **10,601** | **10,173** |
| At not more than one year | 3,406 | 3,902 |
| At more than one but not more than five years | 6,404 | 5,657 |
| At more than five years | 791 | 614 |
| Unearned future finance income on finance leases | (748) | (786) |
| **Net investment in finance leases** | **9,853** | **9,387** |
| At not more than one year | 3,165 | 3,601 |
| At more than one but not more than five years | 5,952 | 5,220 |
| At more than five years | 736 | 566 |
| Accumulated allowance for uncollectible minimum lease payments receivable | 426 | 612 |

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 2012 and 2013 by classes of financial instruments and by individual and collective impairment:

| (CZKm) | Credit Institutions | Non-credit Institutions | Other legal entities | Private Individuals | Total |
|---|---|---|---|---|---|
| **At 1 January 2012** | **217** | **10** | **7,146** | **5,192** | **12,565** |
| Net increase in allowances for credit losses (Note: 12) | (10) | 2 | (13) | 1,652 | 1,631 |
| Write-offs | - | - | (1,164) | (813) | (1,977) |
| Foreign currency translation | (1) | - | (23) | - | (24) |
| **At 31 December 2012** | **206** | **12** | **5,946** | **6,031** | **12,195** |
| Net increase in allowances for credit losses (Note: 12) | (198) | 2 | 309 | 1,265 | 1,378 |
| Write-offs | - | - | (575) | (1,061) | (1,636) |
| Foreign currency translation | - | - | 33 | 2 | 35 |
| **At 31 December 2013** | **8** | **14** | **5,713** | **6,237** | **11,972** |

| (CZKm) | Individual impairment | Collective impairment | Total |
|---|---|---|---|
| **At 1 January 2012** | **11,675** | **890** | **12,565** |
| Increase in allowances for credit losses (Note: 12) | 3,177 | 205 | 3,382 |
| Decrease in allowances for credit losses (Note: 12) | (1,344) | (407) | (1,751) |
| Write-offs | (1,977) | - | (1,977) |
| Transfers | (67) | 67 | - |
| Foreign currency translation | (24) | - | (24) |
| **At 31 December 2012** | **11,440** | **755** | **12,195** |
| Increase in allowances for credit losses (Note: 12) | 2,788 | 337 | 3,125 |
| Decrease in allowances for credit losses (Note: 12) | (1,471) | (276) | (1,747) |
| Write-offs | (1,634) | (2) | (1,636) |
| Transfers | (53) | 53 | - |
| Foreign currency translation | 35 | - | 35 |
| **At 31 December 2013** | **11,105** | **867** | **11,972** |

As at 31 December 2013, the Group possessed assets (mainly cars related to leased assets) with an estimated value of CZK 52 m (2012: CZK 76 m), which the Group is in the process of selling (Note: 24).

## 19. INVESTMENT IN ASSOCIATE AND JOINT VENTURE

In November 2012, ČSOB sold a significant part of its participation in ČSOB Pojišťovna. As a result of the sale, the Group's ownership interest in ČSOB Pojišťovna decreased to 0.24% as at 31 December 2012 (31 December 2011: 25%) (Note: 3).

Effective from January 2012, ČSOB lost control in ČSOB AM/IS but retained significant influence and therefore ČSOB AM/IS is considered to be an associated company (Note: 3).

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

| | ČSOB AM/IS | | ČSOB Pojišťovna | |
|---|---|---|---|---|
| (CZKm) | 2013 | 2012 | 2013 | 2012 |
| **The associate's assets and liabilities** | | | | |
| Assets | 842 | 809 | 42,341 | 43,424 |
| Liabilities | 556 | 525 | 38,591 | 38,624 |
| **Net assets** | **286** | **284** | **3,750** | **4,800** |
| **Carrying amount of the investment** | **115** | **114** | **9** | **12** |
| **The associate's revenue and profit** | | | | |
| Revenue | 348 | 346 | 10,408 | 14,404 |
| Profit for the year | 127 | 130 | 635 | 620 |
| Profit for the year – share of the Group | 51 | 57 | 1 | 138 |

The Group has a 55% ownership interest (2012: 55%) in ČMSS (Note: 3). For 2013 and 2012, the Group's interest in this joint venture is as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Condensed assets and liabilities** | | |
| Cash and balances with central banks | 2,308 | 1,189 |
| Available-for-sale financial assets | 8,545 | 7,846 |
| Loans and receivables | 79,304 | 83,028 |
| Property and equipment | 369 | 393 |
| Goodwill and other intangible assets | 349 | 164 |
| Other assets | 112 | 137 |
| **Total assets** | **90,987** | **92,757** |
| Financial liabilities at amortised cost | 84,607 | 86,054 |
| Tax liabilities | 150 | 239 |
| Other liabilities | 737 | 703 |
| Provisions | 11 | 15 |
| **Total liabilities** | **85,505** | **87,011** |
| **Condensed contingent liabilities** | | |
| Loan commitments | 2,571 | 3,090 |
| **Condensed statement of income** | | |
| Net interest income | 1,413 | 1,710 |
| Net fee and commission income | 408 | 381 |
| Net gains from financial instruments at fair value through profit or loss and foreign exchange | (3) | - |
| Other operating income | 17 | 13 |
| **Operating income** | **1,835** | **2,104** |
| Operating expenses | (739) | (773) |
| Impairment losses | (155) | (67) |
| **Profit before tax** | **941** | **1,264** |
| Income tax expense | (170) | (255) |
| **Profit for the year** | **771** | **1,009** |

## 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 2013 and 2012 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***

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 433,624 | 7,292 | 9,213 | 374,865 | 12,018 | 14,018 |
| Forwards | 52,985 | 14 | 3 | 34,514 | 16 | 18 |
| Options | 31,922 | 198 | 250 | 31,728 | 264 | 339 |
| | **518,531** | **7,504** | **9,466** | **441,107** | **12,298** | **14,375** |
| **Foreign exchange contracts** | | | | | | |
| Swaps / Forwards | 96,760 | 1,790 | 527 | 106,953 | 594 | 743 |
| Cross currency interest rate swaps | 92,062 | 1,918 | 2,829 | 62,945 | 538 | 270 |
| Options | 13,928 | 192 | 197 | 12,022 | 112 | 113 |
| | **202,750** | **3,900** | **3,553** | **181,920** | **1,244** | **1,126** |
| **Commodity contracts** | | | | | | |
| Swaps / Options | 7,650 | 104 | 97 | 7,273 | 126 | 116 |
| **Total trading derivatives (Notes: 16, 26)** | **728,931** | **11,508** | **13,116** | **630,300** | **13,668** | **15,617** |

***Positions of ALM – economic hedges***

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 40,474 | 45 | 443 | 52,934 | 491 | 1,545 |
| Forwards | 501 | - | - | - | - | - |
| **Foreign exchange contracts** | | | | | | |
| Cross currency interest rate swaps | 16,578 | 340 | 845 | 18,345 | 966 | 121 |
| **Total derivatives used as economic hedges (Notes: 16, 26)** | **57,553** | **385** | **1,288** | **71,279** | **1,457** | **1,666** |

### 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). The Group stopped applying cash flow hedge accounting of a group of term deposits denominated in CZK using the CZK single currency swaps at the end of November 2012. The main reasons for the cessation of the cash flow hedge were a significant decline of the volume of eligible term deposits during the previous periods and a forecasted further decrease in their volume. The hedge was reconsidered to be prospectively ineffective.
- 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 / floating rate subordinated debt** to fixed rates. In August 2013, the Group redeemed its subordinated debt and terminated related interest rate swaps used to hedge interest rate risk arising from variability of interest paid on the subordinated debt (Note: 27).

Cross currency interest rate swaps (fix-to-fix or floating-to-fix) 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 2013 and 2012 are set out as follows:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Cash flow hedges** | | | | | | |
| Single currency interest rate swaps | 139,268 | 7,042 | 3,837 | 154,269 | 9,780 | 5,360 |
| Cross currency interest rate swaps | 23,427 | 1,158 | 1,196 | 25,003 | 2,565 | 236 |
| **Total hedging derivatives** | **162,695** | **8,200** | **5,033** | **179,272** | **12,345** | **5,596** |

Net gains and losses on cash flow hedges reclassified to the statement of income are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Interest income (Note: 31) | 246 | 153 |
| Net losses from financial instruments at fair value through profit or loss (Note: 31) | (32) | (259) |
| Taxation (Note: 13) | (41) | 21 |
| **Net gains / (losses)** | **173** | **(85)** |

In 2013, a loss of CZK 20 m was recognised in the statement of income due to hedge ineffectiveness from cash flow hedges (2012: a gain of CZK 14 m).

In 2013, 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 losses of CZK 13 m from equity to the statement of income (2012: CZK 273 m). The losses were 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 hedging derivatives.

The following table shows the notional amounts of hedging derivatives by remaining contractual maturity at 31 December 2013 and 2012:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Less than 3 months | 3,726 | 5,171 |
| More than 3 months but not more than 6 months | 16,667 | 9,529 |
| More than 6 months but not more than 1 year | 23,413 | 21,402 |
| More than 1 year but not more than 2 years | 15,462 | 44,522 |
| More than 2 years but not more than 5 years | 55,699 | 43,426 |
| More than 5 years | 47,728 | 55,222 |
| | **162,695** | **179,272** |

**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.

From March 2009, 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.

From August 2011, 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.

From August 2011, fair value hedges for **portfolios of fixed rate loans** have been used to hedge interest rate risk arising from changes in 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.

From November 2012, 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 2013 and 2012 are set out as follows:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Fair value hedges** | | | | | | |
| *Single currency interest rate swaps* | | | | | | |
| Fair value micro hedges | 23,335 | 212 | 2,147 | 19,804 | - | 2,066 |
| Fair value portfolio hedges | 158,193 | 873 | 2,013 | 93,998 | 1,993 | 1,443 |
| *Cross currency interest rate swaps* | | | | | | |
| Fair value micro hedges | 5,935 | - | 314 | 5,418 | 115 | 61 |
| **Total hedging derivatives** | **187,463** | **1,085** | **4,474** | **119,220** | **2,108** | **3,570** |

In 2013, the net gains in the amount of CZK 874 m (2012: net losses of CZK 223 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 losses realised on the hedging contracts, which are included in Net gains from financial instruments at fair value through profit or loss, amounted to CZK 1,020 m (2012: net gains of CZK 177 m).

## 21. INVESTMENT PROPERTY

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Cost at 1 January | 1,021 | 1,024 |
| Depreciation and impairment at 1 January | (591) | (515) |
| **Net book value at 1 January** | **430** | **509** |
| Additions | 7 | - |
| Transfers to assets held for sale (Note: 24) | (118) | - |
| Depreciation | (25) | (26) |
| Impairment charge (Note: 12) | (9) | (50) |
| Foreign exchange adjustments | 4 | (3) |
| **Net book value at 31 December** | **289** | **430** |
| of which | | |
| Cost | 886 | 1,021 |
| Depreciation and impairment | (597) | (591) |
| **Fair value at 31 December** | **289** | **441** |
| **Other disclosures** | | |
| Rental income | 31 | 78 |
| Direct operating expenses from investments generating rental income | 12 | 20 |
| Direct operating expenses from investments not generating rental income | 1 | 1 |

On 31 December 2013 and 2012, management valued investment property based on a valuation performed by an independent expert, based primarily on the capitalisation of the estimated rental value and unit prices of similar real property, with account being taken of all significant market parameters available on the date of the assessment.

The fair value disclosed for the investment property is based on valuation techniques using significant unobservable inputs.

The impairment losses resulting from the decreased recoverable amount of the investment property in 2013 and 2012 were caused by a decrease of expected future cash-flows.

## 22. PROPERTY AND EQUIPMENT

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2012 | 8,724 | 565 | 608 | 4,347 | 47 | 14,291 |
| Depreciation and impairment at 1 January 2012 | (2,903) | (506) | (435) | (2,333) | - | (6,177) |
| **Net book value at 1 January 2012** | **5,821** | **59** | **173** | **2,014** | **47** | **8,114** |
| Transfers | 287 | 30 | 27 | 915 | (1,259) | - |
| Additions | - | - | - | - | 1,285 | 1,285 |
| Disposals | (6) | (3) | (2) | (335) | - | (346) |
| Disposals through business combinations | - | - | - | (3) | - | (3) |
| Transfers to assets held for sale (Note: 24) | (111) | - | - | - | - | (111) |
| Depreciation | (326) | (28) | (34) | (209) | - | (597) |
| Depreciation related to operating leased assets (Note: 33) | - | - | - | (289) | - | (289) |
| Impairment charge (Note: 12) | (10) | - | - | 2 | - | (8) |
| **Net book value at 31 December 2012** | **5,655** | **58** | **164** | **2,095** | **73** | **8,045** |
| of which | | | | | | |
| Cost | 8,847 | 579 | 619 | 4,494 | 73 | 14,612 |
| Depreciation and impairment | (3,192) | (521) | (455) | (2,399) | - | (6,567) |

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2013 | 8,847 | 579 | 619 | 4,494 | 73 | 14,612 |
| Depreciation and impairment at 1 January 2013 | (3,192) | (521) | (455) | (2,399) | - | (6,567) |
| **Net book value at 1 January 2013** | **5,655** | **58** | **164** | **2,095** | **73** | **8,045** |
| Transfers | 103 | 16 | 25 | 1,121 | (1,265) | - |
| Additions | - | - | - | - | 1,324 | 1,324 |
| Disposals | (182) | (2) | (2) | (400) | - | (586) |
| Transfers to assets held for sale (Note: 24) | (27) | - | - | - | - | (27) |
| Depreciation | (327) | (26) | (34) | (207) | - | (594) |
| Depreciation related to operating leased assets (Note: 33) | - | - | - | (334) | - | (334) |
| Impairment charge (Note: 12) | (50) | - | - | 9 | - | (41) |
| **Net book value at 31 December 2013** | **5,172** | **46** | **153** | **2,284** | **132** | **7,787** |
| of which | | | | | | |
| Cost | 8,738 | 559 | 618 | 4,865 | 132 | 14,912 |
| Depreciation and impairment | (3,566) | (513) | (465) | (2,581) | - | (7,125) |

ČSOB Leasing owns assets leased out under operating leases, which represent 72% (2012: 67%) of the net book value of the Other class of property and equipment.

## 23. GOODWILL AND OTHER INTANGIBLE ASSETS

| (CZKm) | Goodwill | Software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|
| Cost at 1 January 2012 | 3,636 | 4,432 | 844 | 75 | 8,987 |
| Amortisation and impairment at 1 January 2012 | (836) | (4,139) | (698) | - | (5,673) |
| **Net book value at 1 January 2012** | **2,800** | **293** | **146** | **75** | **3,314** |
| Transfers | - | 168 | 24 | (192) | - |
| Additions | - | - | - | 249 | 249 |
| Disposals | - | - | (8) | - | (8) |
| Disposals through business combination | - | (2) | - | (8) | (10) |
| Amortisation | - | (193) | (66) | - | (259) |
| Impairment (Note: 12) | (193) | - | - | - | (193) |
| **Net book value at 31 December 2012** | **2,607** | **266** | **96** | **124** | **3,093** |
| of which | | | | | |
| Cost | 3,636 | 4,559 | 858 | 124 | 9,177 |
| Amortisation and impairment | (1,029) | (4,293) | (762) | - | (6,084) |

| (CZKm) | Goodwill | Software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|
| Cost at 1 January 2013 | 3,636 | 4,559 | 858 | 124 | 9,177 |
| Amortisation and impairment at 1 January 2013 | (1,029) | (4,293) | (762) | - | (6,084) |
| **Net book value at 1 January 2013** | **2,607** | **266** | **96** | **124** | **3,093** |
| Transfers | - | 205 | 26 | (231) | - |
| Additions | - | - | - | 420 | 420 |
| Disposals | - | - | (8) | - | (8) |
| Amortisation | - | (181) | (57) | - | (238) |
| Impairment (Note: 12) | - | - | (33) | - | (33) |
| **Net book value at 31 December 2013** | **2,607** | **290** | **24** | **313** | **3,234** |
| of which | | | | | |
| Cost | 3,636 | 4,764 | 858 | 313 | 9,571 |
| Amortisation and impairment | (1,029) | (4,474) | (834) | - | (6,337) |

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:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Retail / SME – Bank | 2,511 | 2,511 |
| Retail / SME – subsidiaries | | |
| Hypoteční banka | 66 | 66 |
| Other | 30 | 30 |
| | 2,607 | 2,607 |

**Retail / SME - Bank**

The recoverable amount for the Retail / SME - Bank segment was determined based on the value-in-use methodology. The calculation uses cash flow projections from business plans for the forthcoming three 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 / SME - Bank segment are based on 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 9.0% (2012: 10.0%) and no long term growth rates were used in 2013 and 2012.

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 / SME - Bank has been used for extrapolation purposes beyond the budget period.
- The risk discount rate. For Retail / SME - Bank a risk discount rate of 9.0% in 2013 (2012: 10.0%) has been applied. 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 / SME - 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.

**Retail / SME - subsidiaries**

**Hypoteční banka**

The recoverable amount of the Hypoteční banka CGU was determined based on the value-in-use methodology. That calculation uses cash-flow projections based on the financial budgets approved by the management covering a period 2014 - 2016. Cash flows beyond the three-year period have been extrapolated to ten years using the expected average growth rate of 2-3%; after that a terminal value is applied.

The outcome of the impairment assessment was that it is considered unlikely that goodwill in respect of Hypoteční banka 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.

The value in use for Retail / SME – subsidiaries (Hypoteční banka) is particularly sensitive to a number of key assumptions as follows:

- 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 on forecast cash flows beyond the terminal year.
- The risk discount rate. For Retail / SME – subsidiaries segment a risk discount rate of 9.0% in 2013 (2012: 10.0%) has been applied. This represents the 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 market risk premium. A similar approach has been applied for the other businesses.

The key assumptions described above may change as economic and market conditions change.

The recoverable amount of the ČSOB PF Stabilita cash generating unit was determined to be lower than its carrying amount and an impairment loss of CZK 193 m allocated to goodwill was recognised in the 2012 consolidated statement of income.

## 24. NON-CURRENT ASSETS HELD-FOR-SALE

| (CZKm) | Participations | Land and buildings | Other (Note: 18) | Total |
|---|---|---|---|---|
| **Net book value at 1 January 2012** | - | - | **98** | **98** |
| Transfer from Investment in associates (Note:3) | 1,189 | - | - | 1,189 |
| Transfer from Property and equipment (Note: 22) | - | 111 | - | 111 |
| Additions | - | - | 169 | 169 |
| Disposals | (1,189) | (81) | (191) | (1,461) |
| Impairment charge (Note: 12) | - | (21) | - | (21) |
| **Net book value at 31 December 2012** | **-** | **9** | **76** | **85** |
| of which | | | | |
| Cost | - | 23 | 76 | 99 |
| Impairment | - | (14) | - | (14) |

| (CZKm) | Participations | Land and buildings | Other (Note: 18) | Total |
|---|---|---|---|---|
| **Net book value at 1 January 2013** | **-** | **9** | **76** | **85** |
| Transfer from Investment property (Note: 21) | 118 | - | - | 118 |
| Transfer from Property and equipment (Note: 22) | - | 27 | - | 27 |
| Transfer from Other assets and liabilities | 4 | - | - | 4 |
| Additions | - | - | 114 | 114 |
| Disposals | - | (11) | (138) | (149) |
| Impairment charge (Note: 12) | - | (5) | - | (5) |
| **Net book value at 31 December 2013** | **122** | **20** | **52** | **194** |
| of which | | | | |
| Cost | 122 | 27 | 52 | 201 |
| Impairment | - | (7) | - | (7) |

Movements disclosed in Transfer from Investment in associates and Disposals represent part of the investments of the Bank in ČSOB Pojišťovna and ČSOB AM/IS which were sold to KBC Insurance NV and KBC Participations Renta C, SA, respectively, in November 2012 (Note: 3).

In 2013, the Group decided to sell its participation in Property Skalica and thus terminate real estate activity in the Slovak Republic. Movements disclosed in Participations in 2013 represent the transfer of assets and liabilities of Property Skalica to Non-current assets held for sale.

## 25. OTHER ASSETS

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Other debtors, net of provisions (Notes: 32, 34, 37, 40.2) | 854 | 951 |
| Accrued income (Notes: 32, 34, 37, 40.2) | 557 | 446 |
| Prepaid charges | 376 | 306 |
| VAT and other tax receivables | 118 | 87 |
| Other receivables from clients (Notes: 32, 34, 37, 40.2) | 59 | 53 |
| Receivables from securities clearing (Notes: 32, 34, 37, 40.2) | 35 | 176 |
| Other | 24 | 21 |
| | **2,023** | **2,040** |

## 26. FINANCIAL LIABILITIES HELD FOR TRADING

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Short positions | 5,546 | 4,727 |
| Derivative contracts (Note: 20) | | |
| Trading derivatives | 13,116 | 15,617 |
| Derivatives used as economic hedges | 1,288 | 1,666 |
| Term deposits | 59,617 | 10,398 |
| Repo transactions | 102,297 | 96,062 |
| Promissory notes | 80 | 6 |
| Bonds issued | 4,976 | 5,111 |
| **Financial liabilities held for trading** | **186,920** | **133,587** |

## 27. FINANCIAL LIABILITIES AT AMORTISED COST

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Deposits received from central banks** | | |
| Term deposits | **492** | **492** |
| **Deposits received from credit institutions** | | |
| Current accounts | 18,509 | 12,647 |
| Term deposits | 12,607 | 14,411 |
| Repo transactions | 21,025 | 8,307 |
| | **52,141** | **35,365** |
| **Deposits received from other than credit institutions** | | |
| Current accounts | 295,418 | 280,773 |
| Term deposits | 18,212 | 23,370 |
| Savings deposits | 216,267 | 205,234 |
| Building savings deposits | 83,279 | 84,855 |
| Pension funds clients deposits | 32,479 | 28,904 |
| Repo transactions | 10,533 | - |
| Other deposits | 4,154 | 6,486 |
| | **660,342** | **629,622** |
| **Debt securities in issue** | | |
| Bonds issued | 17,638 | 15,079 |
| Promissory notes | 12,552 | 15,251 |
| | **30,190** | **30,330** |
| **Subordinated liabilities** | | |
| Subordinated debt | **-** | **7,983** |
| **Financial liabilities at amortised cost** | **743,165** | **703,792** |

In September 2006 and in February 2007, the Bank issued subordinated debt in the nominal amounts of CZK 5,000 m and CZK 7,000 m, respectively to KBC Bank. Both subordinated debts were issued with a ten-year maturity. Their coupon rate was set up at PRIBOR + 0.35% (interest period 1M, 3M or 6M at the discretion of the Bank) in the first six year period and PRIBOR + 0.85% (interest period 1M, 3M or 6M at the discretion of the Bank) thereafter. The Bank was allowed to prepay the debt at any time following the first six year period. In September 2012, the Bank prepaid a majority of the first tranche in the amount of CZK 4,000 m. In August 2013, the Bank prepaid the whole remaining balance of the subordinated debt.

## 28. OTHER LIABILITIES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Other clearing accounts (Notes: 32, 34, 37, 40.3) | 4,181 | 3,858 |
| Payables to employees including social security charges (Notes: 32, 34, 37, 40.3) | 2,066 | 2,014 |
| Accrued charges (Notes: 32, 34, 37, 40.3) | 2,008 | 1,658 |
| Other debts to clients (Notes: 32, 34, 37, 40.3) | 631 | 696 |
| Other creditors (Notes: 32, 34, 37, 40.3) | 586 | 986 |
| VAT and other tax payables | 353 | 458 |
| Income received in advance | 225 | 271 |
| Payables to securities clearing entities (Notes: 32, 34, 37, 40.3) | 193 | 231 |
| Other (Notes: 32, 34, 37, 40.3) | 742 | 336 |
| | **10,985** | **10,508** |

## 29. PROVISIONS

| (CZKm) | Pending legal issues and other losses | Restructuring | Contractual engagements | Loans commitments and Guarantees (Note: 35) | Total |
|---|---|---|---|---|---|
| **At 1 January 2013** | **322** | **203** | **85** | **325** | **935** |
| Additions | 47 | 1 | 16 | 88 | 152 |
| Amounts utilised | - | (96) | (18) | - | (114) |
| Unused amounts reversed | (1) | (1) | - | (107) | (109) |
| Discount amortisation (Note: 6) | - | - | 3 | - | 3 |
| Foreign currency translation | 2 | (1) | - | 19 | 20 |
| **At 31 December 2013** | **370** | **106** | **86** | **325** | **887** |

*Restructuring*

During 2012, the Group started a restructuring programme to reduce the total number of personnel by 440, resulting in the creation of a provision of CZK 203 m (Note: 10). In accordance with the program, the number of personnel had been reduced by 279 by the end of 2013. The Group expects to use the remaining provision of CZK 106 m to cover the costs related to further reductions of the number of personnel in 2014.

*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 2013, the Group had a provision in the total amount of CZK 370 m. It is expected that the majority of the costs will be probably 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*

The Bank assumed a number of leasehold property arrangements from Investiční a Poštovní banka, a.s. (IPB) for which, on a net basis, the unavoidable contractual rental costs exceeded normal market rental conditions existing as at 19 June 2000, the date when IPB was acquired by ČSOB. 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 5 years.

The Group created a new provision for onerous rental contracts in 2013 and 2012 in the amount of CZK 16 m and CZK 15 m, respectively. It is expected that the costs will be incurred over the next 4 years.

## 30. SHARE CAPITAL AND OTHER RESERVES

As at 31 December 2013, the total authorised share capital was CZK 5,855 m (31 December 2012: CZK 5,855 m) and comprised of 292,750,001 ordinary shares with a nominal value of CZK 20 each (31 December 2012: 292,750,000 ordinary shares with a nominal value of CZK 20 each) and is fully paid up.

Based on the resolution of the sole shareholder dated 11 July 2013, ČSOB issued one ordinary share with a nominal value of CZK 20 and with a share premium of CZK 7,999,999,980 (evidenced by an entry in the Register of Companies dated 23 July 2013).

No Treasury shares were held by the Group at 31 December 2013 and 2012.

On 31 December 2013, the Bank was directly controlled by KBC Bank whose ownership interest in ČSOB was 100% (31 December 2012: 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 2013 and 2012 are as follows:

| (CZKm) | Available-for-sale reserve | Cash flow hedge reserve | Foreign currency translation reserve | Total |
|---|---|---|---|---|
| **At 1 January 2012** | **2,612** | **1,578** | **1** | **4,191** |
| Other comprehensive income (Note: 31) | 3,089 | 1,989 | (1) | 5,077 |
| **At 31 December 2012** | **5,701** | **3,567** | **-** | **9,268** |
| Other comprehensive income (Note: 31) | (1,002) | (1,019) | 2 | (2,019) |
| **At 31 December 2013** | **4,699** | **2,548** | **2** | **7,249** |

Unrealised gains from Available-for-sale financial assets held by the Transformed fund recognised in equity in the amount of CZK 645 m as at 31 December 2013 (31 December 2012: CZK 894 m) were included within Available-for-sale reserve. In accordance with Czech law, when an available-for-sale asset is disposed of 85% of the net realised gains on available-for-sale financial assets will be distributed to pension plan holders.

## 31. COMPONENTS OF OTHER COMPREHENSIVE INCOME

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Exchange differences on translating foreign operation** | 2 | (1) |
| **Cash flow hedges** | | |
| Net unrealised (losses) / gains on cash flow hedges | (1,047) | 2,350 |
| Net (gains) / losses on cash flow hedges reclassified to the statement of income (Note: 20) | (214) | 106 |
| Tax effect relating to cash flow hedges (Note: 13) | 242 | (467) |
| | (1,019) | 1,989 |
| **Available-for-sale financial assets** | | |
| Net unrealised (losses) / gains on available-for-sale financial investments | (678) | 3,940 |
| Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal | (352) | (129) |
| Net realised gains on available-for-sale financial investments amortised to the statement of income on reclassified assets (Note: 17) | (150) | - |
| Realised losses on available-for-sale financial investments reclassified to the statement of income on impairment (Note: 12) | - | 26 |
| Tax effect relating to available-for-sale financial investments (Note: 13) | 178 | (560) |
| | (1,002) | 3,277 |
| **Share of other comprehensive income of associates** | - | (188) |
| **Other comprehensive income for the year, net of tax attributable to owners of the parent** | **(2,019)** | **5,077** |
| Non-controlling interests | - | (7) |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | **(2,019)** | **5,070** |

Included within the Share of other comprehensive income of associates in 2012 was a gain in the amount of CZK 279 m related to available-for-sale financial investments of ČSOB Pojišťovna which was realised from the other comprehensive income to the statement of income following the sale of the associate and recognised in Other net income.

## 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 and foreign exchange 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 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 and retained interests in securitisations. 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 approval of any new product consist also from assessment of valuation of the product and eventual new valuation model for the product has to be approved before the product is endorsed or approval of the model is blocking condition for the product implementation. The New and Active Product Process also requires regular review of all products and assessment of valuation quality is the 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 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 2013:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | 159,431 | - | 159,431 |
| Debt instruments | 21,513 | 5,587 | 6,306 | 33,405 |
| Derivative contracts | - | 11,893 | - | 11,893 |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | 2,258 | 3,626 | 1,583 | 7,467 |
| Available-for-sale financial assets | | | | |
| Debt securities | 57,502 | 17,466 | 7,663 | 82,631 |
| Equity securities | - | - | 709 | 709 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 927 | - | 927 |
| Derivatives used for hedging | - | 9,285 | - | 9,285 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 5,546 | - | - | 5,546 |
| Derivative contracts | - | 14,404 | - | 14,404 |
| Term deposits | - | 59,617 | - | 59,617 |
| Repo transactions | - | 102,297 | - | 102,297 |
| Promissory notes | - | 80 | - | 80 |
| Bonds issued | - | 4,976 | - | 4,976 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (57) | - | (57) |
| Derivatives used for hedging | - | 9,507 | - | 9,507 |

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 2012:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | 111,785 | - | 111,785 |
| Debt instruments | 15,491 | 13,054 | 6,810 | 35,355 |
| Derivative contracts | - | 15,125 | - | 15,125 |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | 2,131 | 3,691 | 1,530 | 7,352 |
| Available-for-sale financial assets | | | | |
| Debt securities | 65,124 | 18,647 | 7,580 | 91,351 |
| Equity securities | 116 | - | 437 | 553 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 1,030 | - | 1,030 |
| Derivatives used for hedging | - | 14,453 | - | 14,453 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 4,727 | - | - | 4,727 |
| Derivative contracts | - | 17,283 | - | 17,283 |
| Term deposits | - | 10,398 | - | 10,398 |
| Repo transactions | - | 96,062 | - | 96,062 |
| Promissory notes | - | 6 | - | 6 |
| Bonds issued | - | 5,111 | - | 5,111 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 1,741 | - | 1,741 |
| Derivatives used for hedging | - | 9,166 | - | 9,166 |

Until December 2012, the pricing of mortgage bonds was based on CZK government bonds yield and interest rates of interest rate swaps (IRS). Yield curves for estimating future cash flows of mortgage bonds with variable coupon were derived from IRS rates provided by KBC Bank. Yield curves for discounting the estimated future cash flows were based on the yield curve derived from CZK government bonds. As there has been no active market for mortgage bonds in the Czech Republic, estimation of any additional credit spread has been subject to management judgement.

Since December 2012, following the management's analysis of the 2012 market for mortgage bonds characteristics, a new valuation model for mortgage bonds has been implemented. Yield curves used in the model for discounting future cash flows are constructed from IRS rates and respective credit spreads. The credit spreads are derived from available market quotes of mortgage bonds and IRS rates. Yield curves for estimating future cash flows of mortgage bonds with variable coupon are still derived from IRS rates provided by KBC Bank.

The spreads for the first five years of maturity are exclusively derived from market observable quotes of mortgage bonds (the management also validates these quotes by comparison to prices reached in observed market transactions). Therefore mortgage bonds with a maturity of up to five years are included in level 2. The spread for the rest of the curve is derived from observed mortgage bond spread at 5 and 10 years and the 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 5 years were transferred to Level 3, which was the main factor contributing to the Level 3 increase in 2012. The spread according to bond maturity was 65 bps (6-year) to 138 bps (above 25-year) in 2012 and 65 bps (6-year) to 111 bps (above 25-year) in 2013.

As a result of the implementation of the new valuation model in 2012, the Group has recorded unrealised losses of CZK 56 m into the Net gains from financial instruments at fair value through profit or loss and CZK 310 m into the Available-for-sale reserve.

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:

| | Financial assets held for trading | Financial assets designated at fair value | Available-for-sale financial assets | | Total |
|---|---|---|---|---|---|
| (CZKm) | Debt securities | Debt securities | Debt securities | Equity securities | |
| **At 1 January 2012** | **-** | **-** | **-** | **145** | **145** |
| Total gains / (losses) recorded in profit or loss | - | - | - | 83 | 83 |
| Total gains / (losses) recorded in other comprehensive income | - | - | - | 253 | 253 |
| Transfers into level 3 | 6,810 | 1,530 | 7,580 | 71 | 15,991 |
| Sales | - | - | - | (115) | (115) |
| **At 31 December 2012** | **6,810** | **1,530** | **7,580** | **437** | **16,357** |
| Total gains or (losses) recorded in profit or loss related to assets held at the end of the reporting period | (64) | (10) | - | (23) | (97) |
| **At 1 January 2013** | **6,810** | **1,530** | **7,580** | **437** | **16,357** |
| Total gains recorded in profit or loss | 344 | 58 | 238 | 70 | 710 |
| Total gains recorded in other comprehensive income | - | - | 4 | 90 | 94 |
| Transfers into level 3 | 210 | - | - | - | 210 |
| Transfers out of level 3 | (392) | - | - | - | (392) |
| Purchases | 4,756 | - | 1,254 | 186 | 6,196 |
| Settlement | (587) | - | (884) | - | (1,471) |
| Sales | (4,835) | (5) | (529) | (74) | (5,443) |
| **At 31 December 2013** | **6,306** | **1,583** | **7,663** | **709** | **16,261** |
| Total gains recorded in profit or loss related to assets held at the end of the reporting period | 286 | 58 | - | - | **344** |

Total gains or (losses) recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss and foreign exchange, Net realised gains on available-for-sale financial assets and Impairment losses 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 credit spread included in the discount factor applied on estimated future cash flows from the mortgage bonds in periods after fifth year 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 2013, an increase / (decrease) of a credit spread by 50 basis points would (decrease) / increase the fair value of the mortgage bonds included in level 3 by CZK 35 m (2012: CZK 85 m). Such a change of the credit spread is based on the variability of mortgage 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:

| | Transfers from Level 1 to Level 2 | | Transfers from Level 2 to Level 1 | |
|---|---|---|---|---|
| (CZKm) | 2013 | 2012 | 2013 | 2012 |
| **Financial assets** | | | | |
| Financial assets held for trading | | | | |
| Debt instruments | - | 351 | - | - |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | - | 3,078 | - | - |
| Available-for-sale financial assets | | | | |
| Debt securities | - | 8,515 | - | - |

In 2012, transfers of debt instruments included in Financial assets designated at fair value through profit or loss and Available-for-sale financial assets from level 1 to level 2 represent mortgage bonds, for which the market became illiquid.

**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:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| (CZKm) | Carrying value | Fair value | Carrying value | Fair value |
| **Financial assets** | | | | |
| Cash and balances with central banks | 55,036 | 55,036 | 28,293 | 28,293 |
| Loans and receivables | 509,256 | 531,812 | 479,516 | 507,289 |
| Held-to-maturity investments | 150,944 | 167,769 | 138,437 | 160,113 |
| Other assets (Note: 25) | 1,505 | 1,505 | 1,626 | 1,626 |
| **Financial liabilities** | | | | |
| Financial liabilities at amortised cost | 743,165 | 749,788 | 703,792 | 708,176 |
| Other liabilities (Note: 28) | 10,407 | 10,407 | 9,779 | 9,779 |

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 2013:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets for which fair values are disclosed** | | | | |
| Cash and balances with central banks | - | 55,036 | - | 55,036 |
| Loans and receivables | - | 953 | 530,859 | 531,812 |
| Held-to-maturity investments | 166,283 | - | 1,486 | 167,769 |
| Other assets (Note: 23) | - | 1,505 | - | 1,505 |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Financial liabilities at amortised cost | - | 620,814 | 128,974 | 749,788 |
| Other liabilities (Note: 26) | - | 10,407 | - | 10,407 |

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 spread.

The fair values of building savings deposits are estimated by discounting their expected future cash flows using rates currently offered for building savings deposits.

### Debt securities in issue

Bonds issued are publicly traded and their fair values are based on quoted market prices. 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) | 2013 | 2012 |
|---|---|---|
| Cash and balances with central banks (Note: 15) | 45,563 | 18,434 |
| Loans and advances to credit institutions | 17,429 | 15,219 |
| Financial liabilities at amortised cost to credit institutions | (41,277) | (22,973) |
| **Cash and cash equivalents** | **21,715** | **10,680** |

### Change in operating assets

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Net change in cash and balances with central banks (mandatory minimum reserves) | 386 | 1,782 |
| Net change in financial assets held for trading | (43,770) | 16,532 |
| Net change in financial assets designated at fair value through profit or loss | (115) | 3,669 |
| Net change in available-for-sale financial assets | (7,127) | (689) |
| Net change in loans and receivables | (27,602) | (31,130) |
| Net change in derivatives used for hedging | 3,907 | (1,669) |
| Net change in other assets | 21 | 12 |
| | **(74,300)** | **(11,493)** |

### Change in operating liabilities

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Net change in financial liabilities held for trading | 53,333 | (32,327) |
| Net change in financial liabilities at amortised cost | 26,510 | 24,943 |
| Net change in derivatives used for hedging | 341 | 1,816 |
| Net change in other liabilities | 477 | (140) |
| | **80,661** | **(5,708)** |

**Non-cash items included in profit before tax**

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Allowances and provisions for credit losses (Note: 12) | 1,359 | 1,574 |
| Depreciation and amortisation (including investment property) | 857 | 881 |
| Depreciation related to operating leases assets (Note: 22) | 334 | 289 |
| Amortisation of discounts and premiums in held-to-maturity investments | 166 | 661 |
| Impairment on property (Note: 12) | 41 | 8 |
| Impairment on other intangible assets (Note: 12) | 33 | - |
| Impairment on investment property (Note: 12) | 9 | 50 |
| Impairment on non-current assets held-for-sale (Note: 12) | 5 | 21 |
| Impairment on goodwill (Note: 12) | - | 193 |
| Impairment on financial investment (Note: 12) | - | 26 |
| Impairment on other assets (Note: 12) | - | (288) |
| Provisions | (52) | 141 |
| Share of profit of associate | (52) | (195) |
| Net change in fair value adjustments of the hedged items in portfolio hedge | (1,695) | 685 |
| Foreign exchange differences in held-to-maturity investments | (2,068) | 627 |
| Other | 88 | (1,062) |
| | **(975)** | **3,611** |

## 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 2013:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | **Total** |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with Central banks (Note: 15) | 45,097 | - | - | - | **45,097** |
| Financial assets held for trading | | | | | |
| Financial derivatives | 5,384 | 5,233 | 1,276 | - | **11,893** |
| Other than financial derivatives | 171,336 | 16,484 | 5,016 | - | **192,836** |
| Financial assets designated at fair value through profit or loss | 3,427 | 4,040 | - | - | **7,467** |
| Available-for-sale financial assets | 9,379 | 36,883 | 36,369 | 709 | **83,340** |
| Loans and receivables | 129,585 | 153,754 | 225,917 | - | **509,256** |
| Fair value adjustments of the hedged items in portfolio hedge | 361 | 566 | - | - | **927** |
| Held-to-maturity investments | 7,468 | 52,999 | 90,477 | - | **150,944** |
| Derivatives used for hedging | 2,672 | 4,981 | 1,632 | - | **9,285** |
| Other assets (Note: 25) | 1,505 | - | - | - | **1,505** |
| **Total carrying value** | **376,214** | **274,940** | **360,687** | **709** | **1,012,550** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 7,216 | 5,723 | 1,465 | - | **14,404** |
| Other than financial derivatives | 170,327 | 1,567 | 622 | - | **172,516** |
| Financial liabilities at amortised cost | 216,874 | 253,960 | 272,331 | - | **743,165** |
| Fair value adjustments of the hedged items in portfolio hedge | 13 | 20 | (90) | - | **(57)** |
| Derivatives used for hedging | 2,888 | 4,712 | 1,907 | - | **9,507** |
| Other liabilities (Note: 28) | 10,407 | - | - | - | **10,407** |
| **Total carrying value** | **407,725** | **265,982** | **276,235** | **-** | **949,942** |

The following table sets out the financial assets and liabilities of the Group by expected remaining maturity as at 31 December 2012:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with Central banks (Note: 15) | 19,240 | - | - | - | **19,240** |
| Financial assets held for trading | | | | | |
| Financial derivatives | 4,965 | 7,797 | 2,364 | - | **15,126** |
| Other than financial derivatives | 126,708 | 13,882 | 6,549 | - | **147,139** |
| Financial assets designated at fair value through profit or loss | 77 | 7,275 | - | - | **7,352** |
| Available-for-sale financial assets | 5,043 | 55,721 | 30,587 | 553 | **91,904** |
| Loans and receivables | 114,596 | 136,883 | 228,037 | - | **479,516** |
| Fair value adjustments of the hedged items in portfolio hedge | 306 | 724 | - | - | **1,030** |
| Held-to-maturity investments | 10,462 | 36,764 | 91,211 | - | **138,437** |
| Derivatives used for hedging | 3,434 | 7,725 | 3,294 | - | **14,453** |
| Other assets (Note: 25) | 1,626 | - | - | - | **1,626** |
| **Total carrying value** | **286,457** | **266,771** | **362,042** | **553** | **915,823** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 5,720 | 9,015 | 2,548 | - | **17,283** |
| Other than financial derivatives | 114,767 | 1,430 | 107 | - | **116,304** |
| Financial liabilities at amortised cost | 200,523 | 252,731 | 250,538 | - | **703,792** |
| Fair value adjustments of the hedged items in portfolio hedge | 196 | 721 | 824 | - | **1,741** |
| Derivatives used for hedging | 2,894 | 4,615 | 1,657 | - | **9,166** |
| Other liabilities (Note: 28) | 9,779 | - | - | - | **9,779** |
| **Total carrying value** | **333,879** | **268,512** | **255,674** | **-** | **858,065** |

## 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 uncertainty regarding the continuing court proceedings following the appeal by the counterparty against the ruling, the Group will not recognise this amount in the statement of income until the final court ruling regarding the Group's claim is known. 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 appeal court.

In 2013, the Group successfully completed another case. Based on the final court decision, the Group recognised a recovery (received already in 2010) relating to partially impaired loan in the amount of CZK 695 m as follows. An unimpaired part of the loan in the amount of CZK 319 m was redeemed and derecognised from the statement of the financial position. In the statement of income, penalty interest in the amount of CZK 178 m was recognised in Other net income, allowances in the amount of CZK 197 m were reversed in Impairment losses from loans and receivables and court expenses compensation income in the amount of CZK 1 m was recognised in General administrative expenses.

**Contingent liabilities and commitments**

The contingent liabilities and commitments at 31 December 2013 and 2012 are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Loan commitments – irrevocable (Note: 40.2) | 90,397 | 80,258 |
| Loan commitments – revocable | 31,119 | 30,086 |
| Financial guarantees (Note: 40.2) | 28,048 | 24,871 |
| Other commitments (Note: 40.2) | 2,418 | 1,493 |
| | **151,982** | **136,708** |
| Provisions for loan commitments and guarantees (Notes: 29, 40.2) | 325 | 325 |

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).

**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, 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) | 2013 | 2012 |
|---|---|---|
| Not later than 1 year | 1,733 | 1,375 |
| Later than 1 year and not later than 5 years | 1,780 | 1,400 |
| Later than 5 years | 176 | 260 |
| | **3,689** | **3,035** |

Future minimum sublease payments amounted to CZK 79 m as at 31 December 2013 (31 December 2012: CZK 25 m).

Operating lease commitments related to information technologies to KBC Global Services NV are included in ‘Not later than 1 year’ in the amount of CZK 949 m (2012: CZK 833 m). They represent expected half-year lease payments according to the committed notice period.

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) | 2013 | 2012 |
|---|---|---|
| Not later than 1 year | 525 | 508 |
| Later than 1 year and not later than 5 years | 1,081 | 961 |
| Later than 5 years | 2 | 2 |
| | **1,608** | **1,471** |

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.

## 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) | 2013 | 2012 |
|---|---|---|
| **Financial assets** | | |
| Cash and balances with central banks | 32,000 | 7,500 |
| Financial assets held for trading | 139,864 | 95,819 |
| Loans and receivables | 2,759 | 2,633 |
| | **174,623** | **105,952** |

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 2013 was CZK 179,097 m, of which CZK 100,588 m has been either sold or repledged (31 December 2012: CZK 115,742 m and CZK 99,317 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) | 2013 | 2012 |
|---|---|---|
| **Financial liabilities** | | |
| Financial liabilities held for trading | 102,297 | 96,062 |
| Financial liabilities at amortised cost | 31,558 | 8,307 |
| | **133,855** | **104,369** |

Amounts of financial assets pledged as collateral in repo transactions 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 2013:

| (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 |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 14,880 | - | 14,880 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 6,298 | - | 6,298 |
| **Total trading and hedging derivatives** | **21,178** | **-** | **21,178** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 174,623 | - | 174,623 |
| **Total repurchase agreements (Note: 36)** | **174,623** | **-** | **174,623** |
| Other financial assets set-off in the balance sheet | 263 | 263 | - |
| Other financial assets not set-off that are not subject to an enforceable master netting arrangement | 1,505 | - | 1,505 |
| **Total other financial assets (Note: 25)** | **1,768** | **263** | **1,505** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,656 | - | 18,656 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 5,255 | - | 5,255 |
| **Total trading and hedging derivatives** | **23,911** | **-** | **23,911** |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 13,099 | - | 13,099 |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 120,756 | - | 120,756 |
| **Total repurchase agreements (Note: 36)** | 133,855 | - | 133,855 |
| Other financial liabilities set-off in the balance sheet | 263 | 263 | - |
| Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement | 10,407 | - | 10,407 |
| **Total other financial liabilities (Note: 28)** | **10,670** | 263 | 10,407 |

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 2012:

| (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 |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,136 | - | 23,136 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 6,442 | - | 6,442 |
| **Total trading and hedging derivatives** | **29,578** | **-** | **29,578** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 105,952 | - | 105,952 |
| **Total repurchase agreements (Note: 36)** | **105,952** | **-** | **105,952** |
| Other financial assets set-off in the balance sheet | 401 | 401 | - |
| Other financial assets not set-off that are not subject to an enforceable master netting arrangement | 1,626 | - | 1,626 |
| **Total other financial assets (Note: 25)** | **2,027** | **401** | **1,626** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,057 | - | 23,057 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 3,392 | - | 3,392 |
| **Total trading and hedging derivatives** | 26,449 | - | 26,449 |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 104,369 | - | 104,369 |
| **Total repurchase agreements (Note: 36)** | **104,369** | **-** | **104,369** |
| Other financial liabilities set-off in the balance sheet | 401 | 401 | - |
| Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement | 9,779 | - | 9,779 |
| **Total other financial liabilities (Note: 28)** | **10,180** | **401** | **9,779** |

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 2013:

| (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 | |
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 14,880 | 13,585 | 829 | - | 466 |
| **Total carrying value** | **14,880** | **13,585** | **829** | **-** | **466** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,656 | 13,585 | 4,919 | - | 152 |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 13,099 | - | - | 13,099 | - |
| **Total carrying value** | **31,755** | **13,585** | **4,919** | **13,099** | **152** |

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 2012:

| (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 | |
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,136 | 19,666 | 3,117 | - | 353 |
| **Total carrying value** | **23,136** | **19,666** | **3,117** | **-** | **353** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,057 | 19,666 | 2,852 | - | 539 |
| **Total carrying value** | **23,057** | **19,666** | **2,852** | **-** | **539** |

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 is executed with related parties in the normal course of business.

The outstanding balances of assets from related party transactions as at 31 December 2013 are as follows:

| (CZKm) | 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 / Senior management | - | - | - | - | - | - |
| KBC Bank | 3,012 | - | - | 3,078 | 3,901 | - |
| Entities under common control | | | | | | |
| ČSOB SK | 439 | - | - | 146 | 116 | - |
| KBC Internationale Financieringsmij NV | 310 | 673 | 704 | 6,333 | - | - |
| Patria Direct, a.s. | 1 | - | - | - | - | - |
| Patria Finance, a.s. | 34 | - | - | - | - | - |
| Other | 73 | - | - | 204 | - | 28 |
| Associates | | | | | | |
| ČSOB AM/IS | - | - | - | - | - | 146 |
| ČSOB Pojišťovna | - | - | - | - | 279 | 59 |
| Joint ventures | | | | | | |
| ČMSS | - | - | - | 850 | - | 38 |

The outstanding balances of liabilities from related party transactions as at 31 December 2013 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Senior management | - | 74 | - | 49 |
| KBC Bank | 47,855 | 13,358 | 5,899 | 2 |
| Entities under common control | | | | |
| ČSOB SK | 13 | 49 | - | - |
| KBC Group | - | 3 | - | 272 |
| KBC Global Services NV | | | | |
| Patria Direct, a.s. | 13 | 2,999 | - | - |
| Patria Finance, a.s. | - | 819 | - | - |
| Other | 13 | 178 | - | 3 |
| Associates | | | | |
| ČSOB AM/IS | - | 592 | - | 18 |
| ČSOB Pojišťovna | 74 | 3,855 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 10,640 | - | - |

The outstanding balances of assets from related party transactions as at 31 December 2012 are as follows:

| (CZKm) | 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 / Senior management | - | - | - | - | - | - |
| KBC Bank | 5,346 | - | - | 3,810 | 7,341 | - |
| Entities under common control | | | | | | |
| ČSOB SK | 132 | - | - | 105 | 7 | - |
| KBC Internationale Financieringsmij NV | 543 | 634 | 698 | 6,343 | - | - |
| Patria Direct, a.s. | 75 | - | - | - | - | - |
| Patria Finance, a.s. | 56 | - | - | - | - | - |
| Other | 39 | - | - | 256 | - | - |
| Associates | | | | | | |
| ČSOB Pojišťovna | - | - | - | - | 111 | 57 |
| Joint ventures | | | | | | |
| ČMSS | - | - | - | 874 | - | 10 |

The outstanding balances of liabilities from related party transactions as at 31 December 2012 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Senior management | - | 181 | - | 43 |
| KBC Bank | 6,163 | 9,884 | 5,571 | 3 |
| Entities under common control | | | | |
| ČSOB SK | 147 | 13 | - | - |
| KBC Global Services NV | - | 463 | - | 144 |
| Patria Direct, a.s. | - | 1,374 | - | - |
| Patria Finance, a.s. | - | 378 | - | - |
| Other | 42 | 141 | - | 3 |
| Associates | | | | |
| ČSOB AM/IS | - | 554 | | 16 |
| ČSOB Pojišťovna | 32 | 3,768 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 11,576 | - | - |

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:

| (CZKm) | 2013 Interest income | 2013 Interest expense | 2012 Interest income | 2012 Interest expense |
|---|---|---|---|---|
| Directors / Senior management | - | - | - | 5 |
| KBC Bank | 851 | 1,301 | 562 | 922 |
| Entities under common control | | | | |
| ČSOB SK | 2 | - | 2 | - |
| KBC Internationale Financieringsmij NV | 161 | - | 213 | - |
| Kredyt Bank SA | - | - | 25 | - |
| Oxford Street Finance Limited | - | - | 1 | - |
| Patria Direct, a.s. | - | 4 | 1 | 6 |
| Patria Finance, a.s. | - | 2 | 1 | 1 |
| Pembridge Square Limited | - | - | 1 | - |
| Regent Street Limited | - | - | 1 | - |
| Other | 4 | - | 9 | 3 |
| Associates | | | | |
| ČSOB AM/IS | - | 1 | - | 5 |
| ČSOB Pojišťovna | - | 34 | - | 47 |
| Joint ventures | | | | |
| ČMSS | 26 | 139 | 26 | 154 |

The balances of fee and commission income and expenses from related party transactions for the year ended 31 December are as follows:

| (CZKm) | 2013 Fee and commission income | 2013 Fee and commission expense | 2012 Fee and commission income | 2012 Fee and commission expense |
|---|---|---|---|---|
| KBC Bank NV | 57 | 8 | 64 | 1 |
| Entities under common control | | | | |
| KBC Global Services NV | - | 20 | - | 15 |
| KBC Group | - | 16 | - | - |
| Patria Finance, a.s. | - | - | 4 | - |
| Other | 12 | 1 | 10 | - |
| Associates | | | | |
| ČSOB AM/IS | 297 | 68 | 270 | 63 |
| ČSOB Pojišťovna | 322 | - | 336 | - |
| Joint ventures | | | | |
| ČMSS | 2 | 24 | - | 107 |

In accordance with the Group strategy, the Group has been purchasing information and communication services from the related party KBC Global Services NV since 2009. In 2013, KBC Global Services NV merged with KBC Group; KBC Group being the successor company.

Effective from 1 July 2009, the Group concluded office space rental agreement and a service level agreement on a provision of administration services, such as human resources and accounting services, with KBC Global Services NV. In 2013, the Group received income of CZK 75 m (2012: CZK 76 m) from rental payments and related services, received CZK 41 m (2012: CZK 48 m) from the provision of administration services and paid expense of CZK 2,761 m (2012: CZK 2,758 m) for IT services, including rental expenses on information technologies.

In 2013, the Group received income of CZK 102 m (2012: CZK 111 m) from ČSOB SK arising from providing services and support in the following areas such as: electronic banking, cards, payment processing, financial management and risk management.

The new debt instruments issued by the Greek government and EFSF originated from the voluntary exchange of Greek government bonds agreement held by the Group in the total carrying amount of CZK 1,115 m were sold at market price to KBC Credit Investments NV on 30 March 2012 (Note: 17).

In January 2012, the Group lost control over the merged company ČSOB AM/IS and realised a gain on the sale of the share in ČSOB IS to KBC Participations Renta, SA in the amount of CZK 149 m (Note: 3).

In November 2012, ČSOB sold 24.76% of its ownership in ČSOB Pojišťovna to KBC Insurance NV and 4.21% of ČSOB AM/IS to KBC Participations Renta C, SA. As a result of the transactions with the companies under common control, the Group has realised net gain of CZK 1,230 m and CZK 224 m respectively, reported under Other net income in the statement of income for 2012 (Notes: 3, 9).

The outstanding contractual balances of the contingent assets and liabilities to the related parties at 31 December are as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| (CZKm) | Guarantees received | Guarantees given | Guarantees received | Guarantees given |
| KBC Bank | 7,269 | 213 | 7,493 | 198 |
| Entities under common control | | | | |
| ČSOB SK | - | 210 | - | 121 |
| Kereskedelmi és Hitelbank | - | 23 | - | - |
| Patria Direct, a.s. | - | - | 75 | - |
| 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 significant events after the end of 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 risk and market risk, the latter being 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 intended to be 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 II and, when implemented, Basel III, and the regulations of the CNB and other relevant regulators.

**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 ČSOB subsidiaries, associates and joint ventures 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, such as return on average equity (ROAE) and return on allocated capital (ROAC), and aligned consistently within the entire KBC Group, including the 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 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 above-mentioned principles 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,

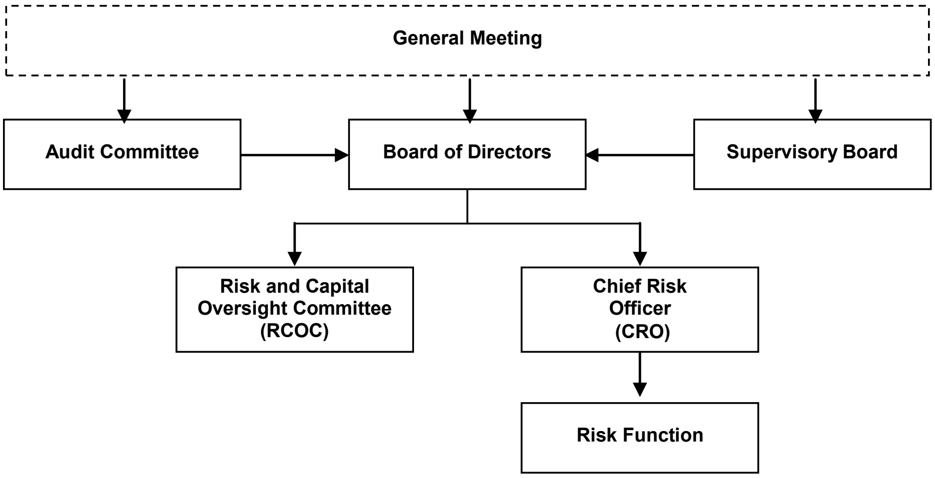
(ii) the RCOC is responsible for proposing the risk appetite and capital allocation to the Board of Directors, translating the approved risk appetite and capital allocation into numerical risk limits within its delegated authority, and regular monitoring of risk and capital against these limits,

(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***

The following chart sets forth an overview of the principal risk and capital management bodies and departments involved in the Group's risk and capital management and control governance and responsibility structure.




*Supervisory Board*

The Supervisory Board is responsible for supervising the Board of Directors and ČSOB's business activities. The Supervisory Board regularly receives integrated risk and capital management reports prepared by the Integrated Risk Management Department (IRMD), as described below.

*Audit Committee*

The risk and capital management function of the Audit Committee is to supervise the risk appetite and capital allocation process, and ensure that appropriate risk controls have been put into place. In addition, the Audit Committee is responsible for ensuring that the Group's risk and capital management policies are in compliance with legal and regulatory requirements. The Audit Committee regularly receives integrated risk management reports prepared by the IRMD.

*Board of Directors*

The Board of Directors is the sole integrated risk decision body responsible for establishing the risk appetite and capital allocation within the Group on an annual basis. This process involves

(i) the approval of the Group's risk appetite statement;

(ii) the approval of the Group's risk and capital strategy;

(iii) the approval of risk limits for the ČSOB group that are consistent with the Group's risk appetite statement and risk and capital management strategy;

(iv) the allocation of regulatory and economic capital to the subsidiaries and business units within the Group with the aim of achieving an acceptable balance between return and risk; and

(v) the approval of the Group's risk and capital management governance structure and ensuring that it conforms with both internal guidelines and regulatory requirements.

On the basis of monthly integrated risk management reports prepared by the IRMD, the Board of Directors is also responsible for monitoring whether the Group's risk exposure is in conformity with the Group's risk 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 are to

(i) propose to the Board of Directors the risk appetite statement, risk and capital management strategy and risk limits for the Group;

(ii) review risk limits at regular intervals and propose changes to the same to the Board of Directors;

(iii) monitor risk exposure against risk limits;

(iv) take corrective actions, if needed, including bringing any material issues or concerns to the Board of Directors; and

(v) monitor capital adequacy and the usage of regulatory and economic capital.

As such, the RCOC assumes to a large extent, the limit setting and monitoring functions of the former ALCO. 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 for specific risk situations. The CRO is the chairman and the CFO is the vice-chairman of the RCOC.

*Chief Risk Officer (CRO)*

The CRO is responsible for ensuring that:

(i) proper risk management frameworks are in place; and

(ii) the Group's risk and capital management strategy is properly implemented through risk management frameworks and policies.

The key responsibilities of the CRO are to:

(i) provide input for the determination of the risk appetite statement, risk and capital management strategy and risk limits for the Group;

(ii) monitor whether risk management frameworks are implemented, maintained and enhanced to manage risk and capital within the risk appetite and capital allocation determined by the Board of Directors;

(iii) determine the design of the Risk Function, as described below;

(iv) determine the risk and capital management measurement techniques and tools, including models, to be used by the Group.

The CRO is a member of the Board of Directors, and regularly prepares reports to be provided by the Board of Directors to the Audit Committee and the Supervisory Board.

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 is a functional unit which underwent certain reorganisation as of November 2013. It consisted of Integrated Risk Management Department (IRMD), Risk Specific Management Department (RSMD), Risk Shared Services Department (RSSD) and Validation Department, each headed by a manager reporting directly to CRO.

The departments had following roles:

*Integrated Risk Management Department (IRMD)*

The IRMD was responsible for managing the process of measuring and monitoring risk on an integrated basis within the Group. In particular, the IRMD performed 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). The IRMD also regularly provided reports to the supervisory section of the CNB.

*Risk Specific Management Department (RSMD)*

The RSMD was responsible for managing credit risk, liquidity risk, operational risk and market risk. In particular, the RSMD was 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.

Within the RSMD, the information security officer was responsible for determining the risk frameworks for informational risk, including cyber risk, and the monitoring of these risks.

*Risk Shared Services Department (RSSD)*

The RSSD was responsible for supporting all the other departments forming the Risk Function in data management and reporting. In particular, the RSSD:

(i) maintains all ICT applications needed for the performance of risk and capital management;

(ii) designs the technical ICT architecture in cooperation with the ICT; and

(iii) performs activities aimed at ensuring the correct flow of data needed for proper risk and capital monitoring.

The RSSD was responsible for risk data governance and also forms the link between the requirements of the IRMD and RSMD departments and the ICT.

*Validation Department*

The Validation Department was responsible for the validation of all risk measurement tools and methodologies used within the Group, which are used to calculate the value of credit, ALM, market and other instruments for risk and capital management purposes, including the risk measurement models developed at the KBC Group level.

Since November 2013, there one division called the Group Risk Management division has been created and is headed by one manager reporting directly to the CRO.

The division consists of the Credit Risk management, the Market and Liquidity risk management department and the Non-financial risk management department.

This group of departments is responsible for managing credit risk, liquidity risk, market risk, operational risk, business risk and strategic risk. In particular, they are:

(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) responsible for information security frameworks for informational risk, including cyber risk, and the monitoring of these risks;

(iv) responsible for integrated risk reporting (see Risk Monitoring and Reporting below);

(v) responsible for the management of economic capital.

The division further consists of the following units:

Integrated Risk Management Team, which is responsible for managing the process of measuring and monitoring risk on an integrated basis within the Group. In particular, the team overseas the ICAAP process (see ICAAP Process below). The Team also regularly provides reports to the supervisory section of the CNB.

The data management department is responsible for supporting all the other departments forming the Risk Function in data management. In particular it:

(i) maintains all ICT applications needed for the performance of risk and capital management;

(ii) designs the technical ICT architecture in cooperation with the ICT; and

(iii) performs activities aimed at ensuring the correct flow of data needed for proper risk and capital monitoring.

*Group Validation Department*

The Validation Department is responsible for the validation of all risk measurement tools and methodologies used within the Group, which are used to calculate the value of credit, ALM, market and other instruments for risk and capital management purposes, including the risk measurement models developed at the KBC Group level.

*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

  (i) where the decision impacts 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 decision impacts 2% of the Group's estimated underlying profit (calculated by Controlling Department for the purposes of management) for the current year.

  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 underlying profit for the current year.

- to the CRO, the authority to decide on matters falling below the above-mentioned thresholds. The CRO may sub-delegate this authority further to one of the departments forming the Risk Function.

Additionally, the CRO may submit to the Board of Directors, the Supervisory Board 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 annually audits 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)*

NAPPs 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 analyzed 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)***

In order to facilitate the performance of day-to-day risk and capital management in close cooperation with the business, the business and the Risk Function conduct BRMs. The BRMs take place on a regular (usually monthly or quarterly) basis, and typically discuss issues concerning the monitoring of risk and implementation of risk frameworks. The BRMs are not decision bodies, but they are a useful platform where business proposals can be discussed from a risk point of view.

***Internal Capital Adequacy Assessment Process***

The New 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).

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 senior 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 National Bank of Belgium).

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.

Information about the ICAAP, including data on the state and anticipated development of internal capital adequacy, is also regularly presented to the senior management, including the RCOC.

When setting and assessing - on an ongoing basis - its internal capital needs, and planning and maintaining its internal capital resources, ČSOB uses a completely economic-value-based 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 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 them when planning and securing internal capital resources. The ICAAP strategic planning horizon is three years.

The amount of capital need is determined using the economic capital method and addresses the following material risks to which the Group is or may be exposed:

- Credit risk, including concentration risk
- Market risk in the trading book
- Operational risk
- ALM risk
- Business risk

A relevant amount of economic capital is allocated directly to these types of risk. Other risks, such as liquidity risk, strategic risk and reputation risk, are covered, under ICAAP processes, by qualitative measures in risk management, organisation of processes, control mechanisms, etc.

The amount of capital need 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 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 senior 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 senior 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 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.

Until September 2012, the Group had been using the IRB Foundation approach for the capital calculations of its non-retail exposures and IRB Advance approach for its retail exposures. As a result, credit risk had been measured, monitored and managed based on principles of this approach.

For the non-retail exposure (Corporate, non-retail SME, Banks, Non-Banking financial institutions), counterparty risk (i.e. default risk) was managed based on statistical default prediction models that establish a rating (PD / Probability of Default) while LGD (Loss Given Default) and EAD (Exposure at Default) were based on regulatory values for capital calculation purposes and on expert estimates combined with historical data for credit decision purposes.

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).

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 principles of this approach.

The counterparty risk (i.e. default risk) is still managed based on statistical default prediction models that establish not only rating (PD / Probability of Default) but also LGD (Loss Given Default) and EAD (Exposure at Default). Risk factors are still determined in Retail based on risk-homogenous sets of exposure (so called pools).

The model results are used for 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.

**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 or 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 11 and 12 represent customers, who have been overdue for 90 days or more, 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 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 irrespective of whether or not they are overdue (after six months of performance, the restructured loan may be requalified); and

PD 1 to PD 9 represent the remaining exposures.

PD ratings are used not only for the measurement, monitoring and management of credit risk, but also to determine, amongst 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:

| ČSOB risk categories for Non-retail exposure | | | | | ČSOB and CNB risk categories | CNB risk categories |
|---|---|---|---|---|---|---|
| PD Scale | PD Rating | S&P's Rating | Performance | Impairment | | |
| Normal | 1-7 | AAA - B | Performing customers | Unimpaired | Non-defaulted | Standard |
| Asset Quality review (AQR) | 8-9 | (B-) - C | Performing customers | Collectively impaired | Non-defaulted | Watched |
| Uncertain – performing | 10 | D | Performing customers | Individually impaired | Defaulted | Substandard |
| Uncertain – non-performing | 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 RSMD 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) or one of its sub-committees consisting of business line employees and employees in the Credit Department. All members of the CSC and its sub-committees must agree in order to approve a credit.

Within the delegation framework set by the RCOC, 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 eye principle", i.e. at least 2 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 (PD 1 – 7 for non-retail SMEs) are reviewed by the distribution with support of monitoring applications. Credit exposures with a rating between PD 9 – 12 (PD 8 – 12 for non-retail SMEs) 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 review at least once a year in accordance with the same application process as for 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 8 in the case of non-retail SME customers, or a PD rating of 9, in the case of corporate customers. For corporate customers, a PD rating of 8 triggers a requirement for a written advice from the Bad Debt Department.

**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:

| ČSOB risk categories for Retail exposure | | | | ČSOB and CNB risk categories | CNB risk categories |
|---|---|---|---|---|---|
| PD Scale | Days overdue | Performance | Impairment | | |
| Normal | 0 - 30 | Performing | Unimpaired | Non-defaulted | Standard |
| Asset Quality review (AQR) | 31 - 90 | Performing | Collectively impaired | 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 loans fall initially within the non-performing category irrespective of whether or not they are overdue.  After six months of performance under the restructured loan, it may be requalified as performing.

*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 in the vast majority of cases fully automated based on scorecards. 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 by the relevant Credit Departments and the RSMD and is based on aggregated data, does not involve individual reviews and looks at the development of defaults within different sub-portfolios. Typically, different product portfolios are reviewed monthly based on so-called vintages (in terms of origination date and number of months on the Group's books) and the development of Credit Cost Ratios in the different sub-portfolios. Additionally, the development of the retail portfolio is monitored 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 starts when any payment is 90 days overdue, and is focused on legal proceedings and the recovery of collateral. All collection units within the Group are managed by the relevant Credit Departments and 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 the 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 (rating AA and better), 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 2013. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Settlement accounts and Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with central banks (Note: 15) | - | 45,097 | - | - | 45,097 |
| Financial assets held for trading | - | 390 | 204,339 | - | 204,729 |
| Financial assets designated at fair value through profit or loss | 192 | 7,275 | - | - | 7,467 |
| Available-for-sale financial assets | 2,748 | 80,592 | - | - | 83,340 |
| Loans and receivables | 493,359 | 12,696 | - | 3,201 | 509,256 |
| Held-to-maturity investments | 192 | 150,752 | - | - | 150,944 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 927 | - | - | 927 |
| Derivatives used for hedging | - | 9,285 | - | - | 9,285 |
| Other assets (Note: 25) | - | - | - | 1,505 | 1,505 |
| Total | 496,491 | 307,014 | 204,339 | 4,706 | 1,012,550 |
| Contingent liabilities (Note: 35) | 30,141 | - | - | - | 30,141 |
| Commitments – irrevocable (Note: 35) | 90,397 | - | - | - | 90,397 |
| Total | 120,538 | - | - | - | 120,538 |
| **Total credit risk exposure** | **617,029** | **307,014** | **204,339** | **4,706** | **1,133,088** |

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2012. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Settlement accounts and Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with central banks (Note: 15) | - | 19,240 | - | - | 19,240 |
| Financial assets held for trading | - | 1,457 | 160,808 | - | 162,265 |
| Financial assets designated at fair value through profit or loss | 176 | 7,176 | - | - | 7,352 |
| Available-for-sale financial assets | 1,267 | 90,637 | - | - | 91,904 |
| Loans and receivables | 461,894 | 12,127 | - | 5,495 | 479,516 |
| Held-to-maturity investments | 601 | 137,836 | - | - | 138,437 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 1,030 | - | - | 1,030 |
| Derivatives used for hedging | - | 14,453 | - | - | 14,453 |
| Other assets (Note: 25) | - | - | - | 1,626 | 1,626 |
| Total | 463,938 | 283,956 | 160,808 | 7,121 | 915,823 |
| Contingent liabilities (Note: 35) | 26,039 | - | - | - | 26,039 |
| Commitments – irrevocable (Note: 35) | 80,258 | - | - | - | 80,258 |
| Total | 106,297 | - | - | - | 106,297 |
| **Total credit risk exposure** | **570,235** | **283,956** | **160,808** | **7,121** | **1,022,120** |

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) | 2013 Gross maximum exposure | 2013 Financial effect of collateral | 2013 Net maximum exposure | 2012 Gross maximum exposure | 2012 Financial effect of collateral | 2012 Net maximum exposure |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and balances with central banks (Note: 15) | 45,097 | 32,000 | 13,097 | 19,240 | 7,500 | 11,740 |
| Financial assets held for trading | 204,729 | 140,036 | 64,693 | 162,265 | 95,889 | 66,376 |
| Financial assets designated at fair value through profit or loss | 7,467 | - | 7,467 | 7,352 | - | 7,352 |
| Available-for-sale financial assets | 83,340 | - | 83,340 | 91,904 | - | 91,904 |
| Loans and receivables | 509,256 | 348,988 | 160,268 | 479,516 | 328,710 | 150,806 |
| Held-to-maturity investments | 150,944 | - | 150,944 | 138,437 | - | 138,437 |
| Fair value adjustments of the hedged items in portfolio hedge | 927 | - | 927 | 1,030 | - | 1,030 |
| Derivatives used for hedging | 9,285 | 657 | 8,628 | 14,453 | 3,048 | 11,405 |
| Other assets (Note: 25) | 1,505 | - | 1,505 | 1,626 | - | 1,626 |
| Total | 1,012,550 | 521,681 | 490,869 | 915,823 | 435,147 | 480,676 |
| Contingent liabilities and Commitments – irrevocable (Note: 35) | 120,538 | 24,699 | 95,839 | 106,297 | 24,651 | 81,646 |
| **Total credit risk exposure** | **1,133,088** | **546,380** | **586,708** | **1,022,120** | **459,798** | **562,322** |

The credit portfolio is structured according to the type of the business the Group enters into:

| **2013** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Mortgage loans | 199,310 | - | 9,247 | **208,557** | (3,213) | - | **205,344** |
| Building savings loans | 67,184 | - | 2,571 | **69,755** | (828) | - | **68,927** |
| Consumer loans | 19,142 | 12 | 8,973 | **28,127** | (1,285) | (5) | **26,837** |
| SME | 73,731 | 3,030 | 23,775 | **100,536** | (3,463) | (53) | **97,020** |
| Leasing | 23,461 | - | 2,363 | **25,824** | (662) | - | **25,162** |
| Corporate | 121,531 | 27,085 | 42,435 | **191,051** | (2,175) | (55) | **188,821** |
| Factoring | 4,072 | - | - | **4,072** | (315) | - | **3,757** |
| Other | 32 | 339 | 1,033 | **1,404** | (31) | (212) | **1,161** |
| **Total credits** | **508,463** | **30,466** | **90,397** | **629,326** | **(11,972)** | **(325)** | **617,029** |

| **2012** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Mortgage loans | 183,571 | - | 7,739 | **191,310** | (2,892) | - | **188,418** |
| Building savings loans | 69,789 | - | 3,091 | **72,880** | (744) | - | **72,136** |
| Consumer loans | 19,129 | 8 | 10,076 | **29,213** | (1,301) | (6) | **27,906** |
| SME | 70,763 | 2,559 | 20,935 | **94,257** | (3,508) | (44) | **90,705** |
| Leasing | 21,820 | - | 1,065 | **22,885** | (798) | - | **22,087** |
| Corporate | 106,536 | 23,568 | 37,021 | **167,125** | (2,389) | (65) | **164,671** |
| Factoring | 3,986 | - | - | **3,986** | (325) | - | **3,661** |
| Other | 539 | 229 | 331 | **1,099** | (238) | (210) | **651** |
| **Total credits** | **476,133** | **26,364** | **80,258** | **582,755** | **(12,195)** | **(325)** | **570,235** |

An industry sector analysis of the Group's Credit portfolio, before taking into account any collateral held or other credit enhancements, is as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| Sector | Granted exposure (CZKm) | Percentage of total exposure | Granted exposure (CZKm) | Percentage of total exposure |
| Private persons | 302,906 | 48.2 | 289,837 | 49.7 |
| Services | 50,563 | 8.0 | 51,369 | 8.8 |
| Distribution | 44,179 | 7.0 | 39,990 | 6.9 |
| Automotive | 32,453 | 5.2 | 24,766 | 4.2 |
| Building and Construction | 26,508 | 4.2 | 27,339 | 4.7 |
| Commercial Real Estate | 24,408 | 3.9 | 23,605 | 4.1 |
| Machinery and Heavy Equipment | 18,529 | 2.9 | 14,002 | 2.4 |
| Authorities | 16,730 | 2.7 | 15,497 | 2.7 |
| Electricity | 14,731 | 2.3 | 12,900 | 2.2 |
| Oil, Gas and other Fuels | 14,549 | 2.3 | 8,582 | 1.5 |
| Finance and Insurance | 13,896 | 2.2 | 14,036 | 2.4 |
| Metals | 11,289 | 1.8 | 12,028 | 2.1 |
| Other sectors | 58,585 | 9.3 | 48,804 | 8.3 |
| **Total** | **629,326** | **100.0** | **582,755** | **100.0** |

The investment portfolio is structured according to type of the instrument.

| **2013** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 237,910 | - | - | - | **237,910** |
| Equity securities | 849 | - | - | (140) | **709** |
| Loans and receivables within investment portfolio | 13,623 | - | - | - | **13,623** |
| Derivatives used for hedging | 9,285 | - | - | - | **9,285** |
| Derivatives held for trading | 390 | - | - | - | **390** |
| Cash and balances with central banks | 45,097 | - | - | - | **45,097** |
| **Total investment** | **307,154** | **-** | **-** | **(140)** | **307,014** |

| **2012** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 235,096 | - | - | - | **235,096** |
| Equity securities | 731 | - | - | (178) | **553** |
| Loans and receivables within investment portfolio | 13,157 | - | - | - | **13,157** |
| Derivatives used for hedging | 14,453 | - | - | - | **14,453** |
| Derivatives held for trading | 1,457 | - | - | - | **1,457** |
| Cash and balances with central banks | 19,240 | - | - | - | **19,240** |
| **Total investment** | **284,134** | **-** | **-** | **(178)** | **283,956** |

The investment portfolio is monitored from a counterparty sector point of view:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| Sector | Granted exposure (CZKm) | Percentage of total exposure | Granted exposure (CZKm) | Percentage of total exposure |
| Central government | 251,645 | 82.0 | 220,986 | 77.8 |
| Credit institutions | 52,156 | 17.0 | 60,363 | 21.3 |
| Corporate | 2,952 | 0.9 | 2,369 | 0.8 |
| Non-credit institutions | 261 | 0.1 | 238 | 0.1 |
| **Total investment** | **307,014** | **100.0** | **283,956** | **100.0** |

The trading portfolio is structured according to type of the instrument.

| 2013 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 33,405 | - | - | **33,405** |
| Loans and advances | 159,431 | - | - | **159,431** |
| Derivatives held for trading | 11,503 | - | - | **11,503** |
| **Total trading portfolio** | **204,339** | **-** | **-** | **204,339** |

| 2012 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 35,354 | - | - | **35,354** |
| Loans and advances | 111,786 | - | - | **111,786** |
| Derivatives held for trading | 13,668 | - | - | **13,668** |
| **Total trading portfolio** | **160,808** | **-** | **-** | **160,808** |

The trading portfolio is monitored from a counterparty sector point of view:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| Sector | Granted exposure (CZKm) | Percentage of total exposure | Granted exposure (CZKm) | Percentage of total exposure |
| Central government | 177,880 | 87.1 | 129,805 | 80.7 |
| Credit institutions | 21,896 | 10.7 | 25,421 | 15.8 |
| Corporate | 4,418 | 2.1 | 5,505 | 3.4 |
| Non-credit institutions | 145 | 0.1 | 77 | 0.1 |
| **Total trading portfolio** | **204,339** | **100.0** | **160,808** | **100.0** |

**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:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| (CZKm) | Total risk | of which Central government | Total risk | of which Central government |
| Czech Republic | 1,042,166 | 418,338 | 937,018 | 340,686 |
| Slovak Republic | 6,493 | 1,389 | 4,999 | 1,035 |
| Greece | 2 | - | - | - |
| Italy | 9,789 | - | 6,720 | - |
| Spain | 576 | - | 176 | - |
| Belgium | 13,817 | 2,594 | 20,913 | 2,449 |
| Hungary | 65 | - | 14 | - |
| Other Europe | 56,744 | 7,708 | 48,788 | 6,913 |
| Other | 3,436 | - | 3,494 | - |
| **Total** | **1,133,088** | **430,029** | **1,022,122** | **351,083** |

Client concentration is monitored on the level of individual portfolios. In the credit portfolio the exposure towards groups of economically connected subjects are monitored:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| Client | Granted exposure (CZKm) | Percentage of total exposure | Granted exposure (CZKm) | Percentage of total exposure |
| 1 largest client | 7,227 | 1.1 | 6,483 | 1.1 |
| 10 largest clients | 44,133 | 7.0 | 32,624 | 5.6 |
| 25 largest clients | 75,611 | 12.0 | 56,951 | 9.8 |

The largest exposure to a single client as at 31 December 2013 was CZK 260,208 m in the investment portfolio (31 December 2012: CZK 211,520 m) to the Czech Government and CZK 158,130 m (31 December 2012: CZK 129,166 m) to the Czech Government in the trading portfolio.

**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, inventory and trade receivables;
- For retail lending, pledges over residential properties are used for mortgage financing.

The Group continuously monitors the market value of all collaterals, 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.

The Group also makes use of master netting agreements with counterparties.

**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, whereas 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 loan with outstanding above 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 is not yet recognised objective evidence of impairment and they reflect impairment that is likely to be present in the group of assets although. Collective allowances are assessed based on statistical estimates and evaluated at each reporting period.

Impairment losses 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); and

(iv) the expected receipts and recoveries once impaired.

The local management is responsible for deciding the length of emergence period. In both 2013 and 2012, the Group used a uniform emergence period of four months, which was confirmed by backtesting.

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 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 at 31 December 2013 and 2012 per individual portfolios:

***Credit portfolio***

| | 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Unimpaired | Impaired assets | | | | Total |
| | assets | Collectively | Individually | | | |
| (CZKm) | Normal | AQR | Uncertain (Performing) | Uncertain (Non-Performing) | Irrecoverable | |
| Mortgage loans | 188,173 | 3,622 | 700 | 1,201 | 5,614 | 199,310 |
| Building savings loans | 64,266 | 1,110 | 685 | 268 | 855 | 67,184 |
| Consumer loans | 17,445 | 255 | 206 | 243 | 993 | 19,142 |
| SME | 67,157 | 1,489 | 1,220 | 495 | 3,370 | 73,731 |
| Leasing | 22,282 | 272 | - | 356 | 551 | 23,461 |
| Corporate | 113,086 | 3,841 | 2,842 | 4 | 1,758 | 121,531 |
| Factoring | 3,136 | - | 828 | - | 108 | 4,072 |
| Other | 1 | - | - | - | 31 | 32 |
| **Total** | **475,546** | **10,589** | **6,481** | **2,567** | **13,280** | **508,463** |

| | 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Unimpaired | Impaired assets | | | | Total |
| | assets | Collectively | Individually | | | |
| (CZKm) | Normal | AQR | Uncertain (Performing) | Uncertain (Non-Performing) | Irrecoverable | |
| Mortgage loans | 172,659 | 3,739 | 591 | 1,563 | 5,019 | 183,571 |
| Building savings loans | 66,464 | 1,574 | 571 | 429 | 751 | 69,789 |
| Consumer loans | 17,365 | 248 | 183 | 248 | 1,085 | 19,129 |
| SME | 64,009 | 1,795 | 1,105 | 443 | 3,411 | 70,763 |
| Leasing | 20,711 | 296 | - | 192 | 621 | 21,820 |
| Corporate | 97,696 | 3,822 | 3,032 | 254 | 1,732 | 106,536 |
| Factoring | 3,103 | - | 734 | - | 149 | 3,986 |
| Other | - | 6 | - | - | 533 | 539 |
| **Total** | **442,007** | **11,480** | **6,216** | **3,129** | **13,301** | **476,133** |

***Investment portfolio***

| | 2013 | | |
|---|---|---|---|
| | Unimpaired assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 237,910 | - | 237,910 |
| Equity securities | 652 | 57 | 709 |
| Loans and receivables within investment portfolio | 13,623 | - | 13,623 |
| Derivatives used for hedging | 9,285 | - | 9,285 |
| Derivative contracts held for trading | 390 | - | 390 |
| Cash and balances with central banks | 45,097 | - | 45,097 |
| **Total** | **306,957** | **57** | **307,014** |

| | 2012 | | |
|---|---|---|---|
| | Unimpaired assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 235,096 | - | 235,096 |
| Equity securities | 544 | 9 | 553 |
| Loans and receivables within investment portfolio | 13,157 | - | 13,157 |
| Derivatives used for hedging | 14,453 | - | 14,453 |
| Derivative contracts held for trading | 1,457 | - | 1,457 |
| Cash and balances with central banks | 19,240 | - | 19,240 |
| **Total** | **283,947** | **9** | **283,956** |

***Trading portfolio***

| | 2013 | | |
|---|---|---|---|
| | Unimpaired assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 33,405 | - | 33,405 |
| Loans and advances | 159,431 | - | 159,431 |
| Derivative contracts held for trading | 11,503 | - | 11,503 |
| **Total** | **204,339** | **-** | **204,339** |

| | 2012 | | |
|---|---|---|---|
| | Unimpaired assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 35,354 | - | 35,354 |
| Loans and advances | 111,786 | - | 111,786 |
| Derivative contracts held for trading | 13,668 | - | 13,668 |
| **Total** | **160,808** | **-** | **160,808** |

The table below shows an ageing analysis of gross past due but not impaired financial assets in the Credit portfolio:

| (CZKm) | 2013<br>Less than 30 days | 2012<br>Less than 30 days |
|---|---|---|
| Mortgage loans | 10,215 | 10,276 |
| Building savings loans | 2,110 | 10,269 |
| Consumer loans | 626 | 433 |
| SME | 265 | 212 |
| Leasing | 62 | 99 |
| Corporate | - | - |
| Factoring | - | - |
| Other | - | - |
| **Total** | **13,278** | **21,289** |

In 2013, a volume of past due building savings loans significantly decreased as a result of improvement of the collection process in ČMSS.

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:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| (CZKm) | Gross amount | Impairment | Gross amount | Impairment |
| Mortgage loans | 7,515 | (2,873) | 7,173 | (2,641) |
| Building savings loans | 1,808 | (755) | 1,751 | (673) |
| Consumer loans | 1,442 | (1,161) | 1,517 | (1,209) |
| SME | 5,085 | (3,333) | 4,958 | (3,401) |
| Leasing | 907 | (542) | 813 | (669) |
| Corporate | 4,604 | (2,111) | 5,018 | (2,308) |
| Factoring | 936 | (299) | 883 | (311) |
| Other | 31 | (31) | 533 | (228) |
| **Total** | **22,328** | **(11,105)** | **22,646** | **(11,440)** |

Individually impaired financial assets included in the investment portfolio in the carrying amounts are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Debt securities | - | - |
| Equity securities | 57 | 9 |
| **Total** | **57** | **9** |

### *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 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).

**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 senior management of the Group.

The NSFR during the year 2013 and 2012 was as follows:

| (%) | 2013 | 2012 |
|---|---|---|
| 31 March | 133.8 | 131.5 |
| 30 June | 134.7 | 130.1 |
| 30 September | 135.3 | 127.6 |
| 31 December | 135.7 | 133.2 |

In addition to internally defined limits, the Group 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 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 2013:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | **Total** |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | - | 7,216 | 5,762 | 1,612 | **14,590** |
| Other than financial derivatives | - | 170,327 | 1,589 | 657 | **172,573** |
| Financial liabilities at amortised cost | 522,736 | 143,455 | 48,547 | 39,875 | **754,613** |
| Fair value adjustments of the hedged items in portfolio hedge | (57) | - | - | - | **(57)** |
| Derivatives used for hedging | - | 2,888 | 4,749 | 2,131 | **9,768** |
| Other liabilities (Note: 28) | - | 10,407 | - | - | **10,407** |
| **Total carrying value** | **522,679** | **334,293** | **60,647** | **44,275** | **961,894** |

The following table sets out the financial liabilities of the Group by remaining contractual maturity as at 31 December 2012:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | **Total** |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | - | 5,720 | 9,120 | 2,759 | **17,599** |
| Other than financial derivatives | - | 114,767 | 1,454 | 112 | **116,333** |
| Financial liabilities at amortised cost | 490,933 | 133,978 | 57,094 | 29,750 | **711,755** |
| Fair value adjustments of the hedged items in portfolio hedge | 1,741 | - | - | - | **1,741** |
| Derivatives used for hedging | - | 2,894 | 4,665 | 1,823 | **9,382** |
| Other liabilities (Note: 28) | - | 9,779 | - | - | **9,779** |
| **Total carrying value** | **492,674** | **267,138** | **72,333** | **34,444** | **866,589** |

The maturity of contingent liabilities and commitments of CZK 151,982 m (2012: CZK 136,708 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. For example, undrawn loan commitments are not expected to be drawn down immediately (Note: 34).

### 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 of EUR 6 m is set for interest rate options; commodity derivatives and structured bonds; the position in these products, however, is not material.

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 real profit or loss made by trading book.

The Group received regulatory approval to use an internal VaR model for the calculation of capital requirements for interest rate and foreign exchange risks in June 2007.

The Group calculate a Stress VaR to fulfill CRD 3 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 2013 and 2012:

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2013 | 119 | 10 | (6) | 123 |
| Average during the period | 134 | 6 | (5) | 135 |
| Highest | 210 | 27 | (22) | 215 |
| Lowest | 56 | 1 | - | 57 |

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2012 | 58 | 4 | (4) | 58 |
| Average during the period | 110 | 8 | (8) | 110 |
| Highest | 173 | 26 | (23) | 176 |
| Lowest | 57 | 1 | (1) | 57 |

**Market risk – Non-trading**

*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 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 2013:

| | | Sensitivity of other comprehensive income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (1.6) | 10.5 | (93.3) | (152.9) | (237.3) |
| EUR | + 10 | 3.4 | 0.2 | 25.6 | 98.6 | 127.8 |
| USD | + 10 | 0.0 | (0.3) | (3.8) | (3.4) | (7.5) |
| CZK | - 10 | 1.6 | (10.5) | 93.3 | 152.9 | 237.3 |
| EUR | - 10 | (3.4) | (0.2) | (25.6) | (98.6) | (127.8) |
| USD | - 10 | 0.0 | 0.3 | 3.8 | 3.4 | 7.5 |

| | | Sensitivity of the statement of income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (1.6) | (1.6) | 15.2 | (6.7) | 5.3 |
| EUR | + 10 | 1.4 | 1.2 | 5.7 | 2.2 | 10.5 |
| USD | + 10 | (0.1) | 0.0 | (2.5) | (2.4) | (5.0) |
| CZK | - 10 | 1.6 | 1.6 | (15.2) | 6.7 | (5.3) |
| EUR | - 10 | (1.4) | (1.2) | (5.7) | (2.2) | (10.5) |
| USD | - 10 | 0.1 | 0.0 | 2.5 | 2.4 | 5.0 |

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 2012:

| | | Sensitivity of other comprehensive income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (6.9) | 9.4 | (141.9) | (363.8) | (503.2) |
| EUR | + 10 | 0.4 | (0.4) | 1.9 | 87.3 | 89.2 |
| USD | + 10 | 0.0 | 0.0 | (4.3) | (5.9) | (10.2) |
| CZK | - 10 | 6.9 | (9.4) | 141.9 | 363.8 | 503.2 |
| EUR | - 10 | (0.4) | 0.4 | (1.9) | (87.3) | (89.2) |
| USD | - 10 | 0.0 | 0.0 | 4.3 | 5.9 | 10.2 |

| | | Sensitivity of the statement of income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (9.9) | 2.5 | 72.5 | (41.8) | 23.3 |
| EUR | + 10 | 0.9 | 0.0 | 5.1 | 2.8 | 8.8 |
| USD | + 10 | (0.1) | 0.0 | (2.6) | (3.3) | (6.0) |
| CZK | - 10 | 9.9 | (2.5) | (72.5) | 41.8 | (23.3) |
| EUR | - 10 | (0.9) | 0.0 | (5.1) | (2.8) | (8.8) |
| USD | - 10 | 0.1 | 0.0 | 2.6 | 3.3 | 6.0 |

*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 2013 and 2012:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| (CZKm) | Net position in foreign currency | 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 | 13 | - | - | 194 | 8 | (8) |

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 2013) 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 |
|---|---|---|
| PX index | - 10 | (45) |
| | + 10 | 45 |
| Dow-Jones / Nasdaq | - 10 | - |
| | + 10 | - |

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 2012) 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 |
|---|---|---|
| PX index | - 10 | (51) |
| | + 10 | 51 |
| Dow-Jones / Nasdaq | - 10 | (12) |
| | + 10 | 12 |

*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 of the Group's products is negligible, however it is regularly monitored.

### *40.5 Operational risk*

The Group defines operational risk in line with Basel II 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 decision of accountable manager, i.e. acceptance of risk or its mitigation by implementing appropriate control measures. Risk events that cannot be prevented may be also mitigated by business continuity arrangements and/or transfers of risk to third parties (e.g. by insurance) to the extent possible.

**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.

*Operational Risk Management Department (ORMD)*

The ORMD is responsible for reporting in the operational risk management area, including coordination, the implementation of methodology, the assurance of independent control, advisory to business units and training. ORMD 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 ORMD 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 the key residual operational risks faced in order to reach a consensus on the adequate risk response (risk acceptance or mitigation).

*Global Risk Scan*

The Global Risk Scan is a structured risk self assessment organised as an interview based on uniform questionnaires. The goal of the exercise is to identify the key risks that are relevant for the senior management. Such risks are likely to differ from the risks identified during the detailed risk scan involving business experts closer to the working floor. Results of Global Risk Scan are used also as underpin of the Economic Capital for Operational and Business risk.

*Group Key Controls and Zero Tolerances*

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 relates to the level of capital a financial institution needs to implement its business plans, taking into consideration the risks that threaten the realisation of such plans.

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.

**Managing solvency**

The Group reports its solvency calculating it on the basis of IFRS figures and the relevant guidelines issued by the Czech regulator - the Czech National Bank, mainly its Decree No. 123/2007 Coll. stipulating the prudential rules for banks, credit unions and investment firms. Regulatory minimum solvency targets were met in 2013, not only at year-end, but also throughout the entire year.

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 II, Pillar 2 requirements, the Group has an Internal Capital Adequacy Assessment Process (ICAAP) in place. In addition to the regulatory capital requirements, this process also uses an economic capital model to measure capital requirements based on aggregate group-wide risks, and to compare these requirements with the capital available to cover risks. The ICAAP examines both the current and future capital situation. To assess the latter situation, a three-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 and a recession scenario.

The Basel III agreement and corresponding European CRD IV Directive and Regulation will introduce new, more stringent capital requirements for financial institutions. According to these requirements, the legal minimum tier-1 ratio, which stood at 4% under Basel II, will be increased to 4.5% in 2014, and gradually increase to 6% (with a common equity ratio of 4.5%). On top of this, a so-called 'capital conservation buffer' (2.5% Common Equity Tier 1), a 'countercyclical buffer' (of between 0% and 2.5% Common Equity Tier 1, to be determined by the national regulatory authority) and an extra charge for systemic risks banks will be applied. The Group analysed the impact of the Basel III and incorporated major changes / ratios into 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 securities.

No significant changes have been made to the objectives, policies and processes from the previous years.

The following table shows the capital and CAD ratio calculated under Basel II for ČSOB Group.

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Tier 1 capital | 55,245 | 44,975 |
| Tier 2 capital | 76 | 7,983 |
| Deductible items of Tier 1 and Tier 2 | (16) | (788) |
| **Total capital** | **55,305** | **52,170** |
| Capital requirements | 28,409 | 27,389 |
| **Risk weighted assets** | **355,114** | **342,360** |
| Capital adequacy ratio | 15.57% | 15.24% |

# INDEPENDENT AUDITOR'S REPORT ON THE SEPARATE FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of Československá obchodní banka, a. s.:

We have audited the accompanying financial statements of Československá obchodní banka, a. s., which comprise the statement of financial position as at 31 December 2013, and the statement of income, statement of comprehensive income, statement of changes in equity, statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. For details of Československá obchodní banka, a. s., see Note 1 to the financial statements.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

EY
Building a better working world

*Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of Československá obchodní banka, a. s. as at 31 December 2013, and 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.

Ernst & Young

Ernst & Young Audit, s.r.o.
License No. 401
Represented by

D. Burnham

Douglas Burnham
Partner

Zedník

Jan Zedník
Auditor, License No. 2201

27 March 2014
Prague, Czech Republic

## *SEPARATE STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| Interest income | 4 | 20,958 | 23,217 |
| Interest expense | 5 | (4,865) | (6,495) |
| **Net interest income** | | **16,093** | **16,722** |
| Fee and commission income | 6 | 7,797 | 7,413 |
| Fee and commission expense | 6 | (2,794) | (2,526) |
| **Net fee and commission income** | | **5,003** | **4,887** |
| Dividend income | | 4,834 | 5,255 |
| Net gains from financial instruments at fair value through profit or loss and foreign exchange | 7 | 2,421 | 2,297 |
| Net realised gains / (losses) on available-for-sale financial assets | | 352 | (136) |
| Other net income | 8 | 803 | 2,052 |
| **Operating income** | | **29,506** | **31,077** |
| Staff expenses | 9 | (5,711) | (5,900) |
| General administrative expenses | 10 | (6,958) | (7,270) |
| Depreciation and amortisation | 20, 21 | (451) | (502) |
| **Operating expenses** | | **(13,120)** | **(13,672)** |
| Impairment losses | 11 | (595) | (504) |
| **Profit before tax** | | **15,791** | **16,901** |
| Income tax expense | 12 | (1,457) | (1,222) |
| **Profit for the year** | | **14,334** | **15,679** |

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

# *SEPARATE STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| **Profit for the year** | | **14,334** | **15,679** |
| Net (loss) / gain on cash flow hedges | 29 | (1,233) | 2,445 |
| Net gain on available-for-sale financial assets | 29 | 3,916 | 3,807 |
| Income tax expense relating to components of other comprehensive income | 29 | (510) | (1,187) |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | | **2,173** | **5,065** |
| **Total comprehensive income for the year, net of tax** | | **16,507** | **20,744** |

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

# *SEPARATE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with central banks | 14 | 52,691 | 27,077 |
| Financial assets held for trading | 15 | 206,040 | 163,219 |
| Financial assets designated at fair value through profit or loss | 15 | 8,543 | 8,367 |
| Available-for-sale financial assets | 16 | 69,581 | 141,012 |
| Held-to-maturity investments | 16 | 145,467 | 132,669 |
| Loans and receivables | 17 | 384,623 | 293,148 |
| Fair value adjustments of the hedged items in portfolio hedge | | 927 | 1,030 |
| Investments in subsidiaries, associates and joint ventures | 18 | 36,250 | 36,347 |
| Derivatives used for hedging | 19 | 9,285 | 14,452 |
| Property and equipment | 20 | 3,226 | 3,621 |
| Goodwill and other intangible assets | 21 | 2,711 | 2,761 |
| Non-current assets held-for-sale | 22 | 20 | - |
| Other assets | 23 | 1,160 | 1,331 |
| **Total assets** | | **920,524** | **825,034** |
| **LIABILITIES AND EQUITY** | | | |
| Financial liabilities held for trading | 24 | 192,473 | 135,870 |
| Financial liabilities at amortised cost | 25 | 636,662 | 608,467 |
| Fair value adjustments of the hedged items in portfolio hedge | | (57) | 1,741 |
| Derivatives used for hedging | 19 | 9,092 | 8,652 |
| Current tax liabilities | | 697 | 613 |
| Deferred tax liabilities | 12 | 991 | 468 |
| Other liabilities | 26 | 8,410 | 8,065 |
| Provisions | 27 | 823 | 912 |
| **Total liabilities** | | **849,091** | **764,788** |
| Share capital | 28 | 5,855 | 5,855 |
| Share premium | | 14,673 | 6,673 |
| Statutory reserve | | 18,687 | 18,687 |
| Retained earnings | | 26,072 | 25,058 |
| Available-for-sale reserve | 28 | 3,607 | 435 |
| Cash flow hedge reserve | 28 | 2,539 | 3,538 |
| **Total equity** | | **71,433** | **60,246** |
| **Total liabilities and equity** | | **920,524** | **825,034** |

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 27 March 2014 by:

Pavel Kavánek
Chairman of the Board of Directors
and Chief Executive Officer

Bartel Puelinckx
Member of the Board of Directors
and Chief Finance Officer

# SEPARATE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2013

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

| (CZKm) | Share capital (Note: 28) | Share premium | Statutory reserve[1] | Retained earnings | Other reserves (Note: 28) | Total Equity |
|---|---|---|---|---|---|---|
| **At 1 January 2012** | **5,855** | **6,673** | **18,687** | **15,975** | **(1,092)** | **46,098** |
| Profit for the year | - | - | - | 15,679 | - | 15,679 |
| Other comprehensive income for the year | - | - | - | - | 5,065 | 5,065 |
| Total comprehensive income for the year | - | - | - | 15,679 | 5,065 | 20,744 |
| Dividends paid (Note: 13) | - | - | - | (6,596) | - | (6,596) |
| **At 31 December 2012** | **5,855** | **6,673** | **18,687** | **25,058** | **3,973** | **60,246** |
| **At 1 January 2013** | **5,855** | **6,673** | **18,687** | **25,058** | **3,973** | **60,246** |
| Profit for the year | - | - | - | 14,334 | - | 14,334 |
| Other comprehensive income for the year | - | - | - | - | 2,173 | 2,173 |
| Total comprehensive income for the year | - | - | - | 14,334 | 2,173 | 16,507 |
| Increase of Share capital and Share premium | - | 8,000 | - | - | - | 8,000 |
| Dividends paid (Note: 13) | - | - | - | (13,320) | - | (13,320) |
| **At 31 December 2013** | **5,855** | **14,673** | **18,687** | **26,072** | **6,146** | **71,433** |

(1) The statutory reserve represents accumulated transfers from retained earnings in compliance with the Czech Commercial Code. This reserve is not distributable and could be used only for compensation of losses incurred.

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

# *SEPARATE STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2013*

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

| (CZKm) | Note | 2013 | 2012 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Profit before tax | | 15,791 | 16,901 |
| Adjustments for: | | | |
| Change in operating assets | 31 | (67,639) | (11,272) |
| Change in operating liabilities | 31 | 75,458 | (2,804) |
| Non-cash items included in profit before tax | 31 | (2,536) | 3,100 |
| Net gains from investing activities | | (16) | (1,331) |
| Income tax paid | | (1,371) | (336) |
| **Net cash flows from / (used in) operating activities** | | **19,687** | **4,258** |
| **INVESTING ACTIVITIES** | | | |
| Purchase of held-to-maturity investments | | (3,260) | (3,164) |
| Acquisition and equity increase of subsidiary, associate and joint venture companies | | - | (3,100) |
| Maturity / disposal of investment securities | | 6,801 | 2,858 |
| Purchase of property, equipment and intangible assets | | (272) | (481) |
| Proceeds from sale and equity decrease of subsidiary, associate and joint venture companies | | 97 | 5,648 |
| Proceeds from disposal of property, equipment, intangible assets and assets held-for-sale | | 195 | 18 |
| **Net cash flows from investing activities** | | **3,561** | **1,779** |
| **FINANCING ACTIVITIES** | | | |
| Repayment of subordinated debt | | (8,000) | (4,000) |
| Increase of share capital and share premium | | 8,000 | - |
| Dividends paid | | (13,320) | (6,596) |
| **Net cash flows used in financing activities** | | **(13,320)** | **(10,596)** |
| **Net increase / (decrease) in cash and cash equivalents** | | **9,928** | **(4,559)** |
| Cash and cash equivalents at the beginning of the year | 31 | 9,489 | 14,048 |
| Net increase / (decrease) in cash and cash equivalents | | 9,928 | (4,559) |
| **Cash and cash equivalents at the end of the year** | 31 | **19,417** | **9,489** |
| **Additional information** | | | |
| Interest paid | | (5,440) | (6,859) |
| Interest received | | 22,548 | 25,393 |
| Dividends received | | 4,834 | 5,255 |

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

# NOTES TO THE SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2013

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).

## 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 ČSOB separate financial statements 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 judgements 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**

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**

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**

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.

**Classification of leases**

Classification of leases into either finance leases or operating leases is based on the extent to which the risks and rewards from the asset ownership have been transferred from a lessor to a lessee. If a substantial number of all the risks and rewards incidental to ownership have been transferred to the lessee the lease is classified as a finance lease. Management judgement is needed to assess the extent to which the risks and rewards have been transferred.

**Deferred tax assets**

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

**Provisions**

Provisions are recognised when a current obligation exists as a result of past events. It is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate of the amount will be made. Judgements are applied to evaluate whether the current obligation exists taking into account all available evidence and whether the event is more likely to occur than not. Estimates of the amount of the obligation also require management judgement.

## *2.3 Changes in accounting policies*

**Effective from 1 January 2013**

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.

**IFRS 1 Government Loans (Amendments)** is effective for periods beginning on or after 1 January 2013. The amendments add an exception to the retrospective application of IFRSs to require that first-time adopters apply the requirements in IAS 20 prospectively to government loans existing at the date of transition to IFRSs.

**IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments)** is effective for periods beginning on or after 1 January 2013. The amendment presents new required disclosures to include information that will enable users of an entity's financial statements to evaluate the effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position.

**IFRS 13 Fair Value Measurement** is effective for periods beginning on or after 1 January 2013. The standard provides guidance on how to measure the fair value of financial and non-financial assets and liabilities. The standard does not have any significant effect on the statement of financial position or income but has increased the amount of information disclosed in the notes.

**IAS 1 Presentation of Items of Other Comprehensive Income (Amendments)** is effective for annual periods beginning on or after 1 July 2012. The amendments change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items which will never be reclassified. The option is retained to present profit or loss and OCI either in a single continuous statement or in two separate, but consecutive, statements.

**IAS 19 Employee Benefits (Revision)** is effective for periods beginning on or after 1 January 2013. The main changes within the revised standard relate to the accounting treatment of the category of post-employment benefits - defined benefit plans:

- The corridor mechanism for pension plans is abolished and all changes in the value of defined benefit plans will be recognised as they occur
- The presentation options of actuarial results are eliminated
- The level of disclosures has increased

Other smaller changes to the short-term employee benefits and termination benefits and a number of minor clarifications and re-wording are included in the revised standard.

**Improvements to IFRSs**, issued in May 2012 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard. None of these have a significant impact on the accounting policies, financial position or performance of the Bank.

**Effective after 1 January 2013**

The following standards, amendments and interpretations have been issued and are effective after 1 January 2013. 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 (2013)** is available for application, however, it does not set the mandatory effective date. The uncertainty is due to the fact that the project on impairment of financial assets is still in progress. The previous effective date of 2015 has been removed from the standard until the impairment phase of the project is completed. The standard has not been endorsed by the European Commission to date.

The project to replace the current IAS 39 Financial Instruments: Recognition and Measurement has been divided into three phases. The first phase focuses on classification and measurement of financial instruments.

The new standard has reduced the number of asset measurement categories from four to two. Debt instruments are classified at amortised cost or fair value on the basis of both:

- The entity's business model for managing financial assets; and
- The contractual cash flow characteristics of the financial asset.

Debt instruments may be measured at amortised cost if both conditions are met:

- The 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.

Reclassifications between the two asset categories are required when the entity changes its business model. IFRS 9 retains a fair value option. At initial recognition entities can elect to measure financial assets at fair value, although they would otherwise qualify for amortised cost measurement. IFRS 9 removes the separation of embedded derivatives and the instrument is assessed in its entirety as to whether it fulfils the above two conditions.

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

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 caused by changes in its own credit quality are recognised in other comprehensive income (OCI) rather than in the statement of income. The entity can choose to apply this policy without applying other IFRS 9 requirements at the same time.

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

The standard will have a significant impact on the Bank financial statements, however due to the uncertainties about the second, impairment phase, and the macro hedging project, the impact of the IFRS 9 is not reasonably estimable.

The third phase, micro hedge accounting, aligns more closely the hedge accounting and risk management. In practice, more hedging strategies used for risk management will qualify for hedge accounting. The three types of hedge accounting (cash flow, fair value and net investment hedges) have been carried forward from IAS 39. The hedging relationship has to be effective at inception and on an ongoing basis and will be subject to a qualitative or quantitative forward-looking effectiveness assessment. The hedge effectiveness range of 80-125% is replaced by an objective-based test. If the hedging relationship meets risk management objectives it cannot be voluntarily terminated, rather, the quantities of hedged item or a hedging instrument have to be adjusted and hedged ratio rebalanced to comply with hedge effectiveness requirement.

Non-derivative financial assets and liabilities with fair value through profit or loss can be designated as hedging instruments in hedging relationships of any risk, not just foreign currency risk. They have to be designated in their entirety or as a proportion of their nominal amount.

The hedge accounting model extends the eligibility of risk components to include non-financial items, provided the component is separately identifiable and can be reliably measured. The current status of the third phase of IFRS 9 is exposure draft.

**IFRS 10 Consolidated Financial Statements** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard replaces the part relating to the consolidated portion of IAS 27 Consolidated and Separate Financial Statements. A new definition of control is included and a single control model that applies to all entities is introduced.

**IFRS 11 Joint Arrangements** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard replaces IAS 31 Interests in Joint Ventures and SIC 13 Jointly-controlled Entities – Non-monetary Contributions by Venturers. The standard will have an impact on the consolidated financial statements of the Group.

**IFRS 12 Disclosure of Interest in Other Entities** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard includes all of the disclosure requirements that were included in IAS 27, IAS 28 and IAS 31. The entity will be required to disclose judgements made to determine whether it controls an entity.

**IFRS 10, 11, 12 Transition Guidance (Amendments)** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The amendments change the transition guidance to provide further relief from full retrospective application. The amendments clarify that an entity is not required to make adjustments to the previous accounting for its involvement with entities if the consolidation conclusion reached at the date of initial application is the same when applying IAS 27/SIC-12 and when applying IFRS 10.

**Investment Entities (Amendments to IFRS 10, 12 and IAS 27)** is effective for periods beginning on or after 1 January 2014. The amendments define an investment entity and introduce an exception to consolidating particular subsidiaries for investment entities. These amendments require an investment entity to measure those subsidiaries at fair value through profit or loss in its consolidated and separate financial statements. The amendments also introduce new disclosure requirements for investment entities in IFRS 12 and IAS 27.

**IAS 27 Separate Financial Statements (Amendment)** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

**IAS 28 Investments in Associates and Joint Ventures (Amendment)** is effective for periods beginning on or after 1 January 2013. The standard was endorsed by the European Commission for use on or after 1 January 2014 with a possible early application. The standard prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

**IAS 32 Offsetting Financial Assets and Financial Liabilities (Amendments)** is effective for periods beginning on or after 1 January 2014. These amendments clarify the meaning of “currently has a legally enforceable right to set-off” and also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous.

**Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)** is effective for periods beginning on or after 1 January 2014. The amendments provide relief from discontinuing hedge accounting when the novation of a derivative designated as a hedging instrument meets certain criteria. Similar relief will be included in IFRS 9 *Financial Instruments*.

**Recoverable Amount Disclosures for Non-financial Assets (Amendments to IAS 36)** is effective for periods beginning on or after 1 January 2014. The amendment clarifies the disclosure requirements of IAS 36 in relation to the standard IFRS 13 *Fair value measurement.*

**Defined Benefit Plans: Employees Contributions (Amendments to IAS 19)** is effective for periods beginning on or after 1 July 2014. The amendment brings clarification of the accounting requirements for contributions from employees or third parties to a defined benefit plan. It specifies conditions under which the contributions can be accounted for as a reduction of service costs.

**IFRIC 21 Levies** is effective for periods beginning on or after 1 January 2014. IFRIC 21 provides guidance on when to recognise a liability for a levy imposed by a government, both for levies that are accounted for in accordance with IAS 37 and those where the timing and amount of the levy is certain. IFRIC 21 identifies the obligating event for the recognition of a liability as the activity that triggers the payment of the levy in accordance with the relevant legislation.

**Improvements to IFRSs**, issued in December 2013 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard.

## *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 another entity (parent entity). Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. 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 over an economic activity, and exists only when the strategic, financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

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.

Investments in subsidiaries, associates and jointly controlled entities are carried at cost less any provision for impairment. Dividends received from investments in subsidiaries, associates and jointly controlled entities 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*

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) 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 amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction. 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 come 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) 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 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 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.

*(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 (excluding mandatory minimum reserves), loans and advances to credit institutions (measured at both amortised cost and at fair value) and financial liabilities at amortised cost to credit institutions.

**(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) Goodwill**

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.

**(17) Intangible assets**

Intangible assets include software, licences and other intangible assets.

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.

Amortisation of the 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:

| | |
|---|---|
| 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 recognised 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 and 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) Taxes**

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 Commercial Code and its use is limited by this legislation and the Articles of association or Statutes. The fund is not available for distribution to shareholders.

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 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 / SME:** Private individuals and entrepreneurs and companies with a turnover of less than CZK 300 m. This segment contains customers' deposits, consumer loans, overdrafts, credit card facilities, mortgages, funds transfer facilities and other transactions and balances with retail and SME customers. Margin income from operations with retail and SME 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).

**Corporate:** Companies with a turnover greater than CZK 300 m and financial institutions. This segment contains customers' deposits, loans, overdrafts, credit card facilities, funds transfer facilities and other transactions and balances with corporate customers. Margin income from the operations with corporate 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).

**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 the results of the reinvestment of free equity of the Bank, dividends from subsidiaries, associates and joint ventures, Asset Liability Management (ALM) and income and expenses not directly attributable to other segments. In 2012, net gains on the disposal of participations in ČSOB Pojišťovna, a. s., a member of the ČSOB holding and ČSOB Asset Management, a.s., investment company are included.

**Segment reporting information by customer segments for 2013**

| (CZKm) | Retail / SME | Corporate | Financial markets | Group Centre | Total |
|---|---|---|---|---|---|
| ***Statement of income*** | | | | | |
| Net interest income | 11,297 | 2,827 | 627 | 1,342 | 16,093 |
| Net fee and commission income | 3,921 | 876 | 388 | (182) | 5,003 |
| Dividend income | - | - | - | 4,834 | 4,834 |
| Net gains from financial instruments at fair value through profit or loss | 1,177 | 798 | 15 | 431 | 2,421 |
| Net realised gains on available-for-sale financial assets | - | - | - | 352 | 352 |
| Other net income | 176 | 14 | - | 613 | 803 |
| **Operating income** | **16,571** | **4,515** | **1,030** | **7,390** | **29,506** |
| *of which:* | | | | | |
| *External operating income* | *8,093* | *4,173* | *1,030* | *16,211* | *29,506* |
| *Internal operating income* | *8,478* | *342* | *-* | *(8,821)* | *-* |
| Depreciation and amortisation | (76) | - | - | (375) | (451) |
| Other operating expenses | (10,229) | (1,475) | (326) | (639) | (12,669) |
| **Operating expenses** | **(10,305)** | **(1,475)** | **(326)** | **(1,014)** | **(13,120)** |
| Impairment losses - additions | (1,416) | (367) | - | (140) | (1,923) |
| Impairment losses - reversals | 642 | 411 | - | 275 | 1,328 |
| **Profit before tax** | **5,492** | **3,084** | **704** | **6,511** | **15,791** |
| Income tax (expense) / benefit | (1,024) | (586) | (134) | 287 | (1,457) |
| **Segment profit** | **4,468** | **2,498** | **570** | **6,798** | **14,334** |
| ***Assets and liabilities*** | | | | | |
| Segment assets | 92,488 | 122,395 | 238,850 | 466,771 | 920,504 |
| Non-current assets held-for-sale | - | - | - | 20 | 20 |
| **Total assets** | **92,488** | **122,395** | **238,850** | **466,791** | **920,524** |
| **Total liabilities** | **454,330** | **105,810** | **192,331** | **96,620** | **849,091** |
| **Capital expenditures** | **86** | **2** | **-** | **184** | **272** |

**Segment reporting information by customer segments for 2012**

| (CZKm) | Retail / SME | Corporate | Financial markets | Group Centre | Total |
|---|---|---|---|---|---|
| ***Statement of income*** | | | | | |
| Net interest income | 11,592 | 2,709 | 754 | 1,667 | 16,722 |
| Net fee and commission income | 3,808 | 920 | 301 | (142) | 4,887 |
| Dividend income | - | - | - | 5,255 | 5,255 |
| Net gains / (losses) from financial instruments at fair value through profit or loss | 1,088 | 773 | 626 | (190) | 2,297 |
| Net realised losses on available-for-sale financial assets | - | - | - | (136) | (136) |
| Other net income | 174 | 5 | (1) | 1,874 | 2,052 |
| **Operating income** | **16,662** | **4,407** | **1,680** | **8,328** | **31,077** |
| *of which:* | | | | | |
| *External operating income* | *7,238* | *4,127* | *1,680* | *18,032* | *31,077* |
| *Internal operating income* | *9,424* | *280* | *-* | *(9,704)* | *-* |
| Depreciation and amortisation | (104) | (1) | - | (397) | (502) |
| Other operating expenses | (10,443) | (1,466) | (322) | (939) | (13,170) |
| **Operating expenses** | **(10,547)** | **(1,467)** | **(322)** | **(1,336)** | **(13,672)** |
| Impairment losses - additions | (1,409) | (492) | - | (271) | (2,172) |
| Impairment losses - reversals | 605 | 718 | - | 345 | 1,668 |
| **Profit before tax** | **5,311** | **3,166** | **1,358** | **7,066** | **16,901** |
| Income tax (expense) / benefit | (1,050) | (603) | (258) | 689 | (1,222) |
| **Segment profit** | **4,261** | **2,563** | **1,100** | **7,755** | **15,679** |
| ***Assets and liabilities*** | | | | | |
| **Total assets** | **89,417** | **107,904** | **169,325** | **458,388** | **825,034** |
| **Total liabilities** | **436,292** | **99,877** | **134,357** | **94,262** | **764,788** |
| **Capital expenditures** | **246** | **4** | **-** | **231** | **481** |

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) | 2013 | 2012 |
|---|---|---|
| Cash balances with central banks | 11 | 136 |
| Loans and receivables | | |
| Credit institutions | 2,872 | 2,435 |
| Other than credit institutions | 7,779 | 8,146 |
| Available-for-sale financial assets | 2,765 | 4,263 |
| Held-to-maturity investments | 5,671 | 5,585 |
| Financial assets held for trading (Note: 7) | 783 | 1,489 |
| Financial assets designated at fair value through profit or loss (Note: 7) | 247 | 299 |
| Derivatives used as economic hedges (Note: 7) | 198 | 378 |
| Derivatives used for hedging (Note: 7) | 632 | 486 |
| | **20,958** | **23,217** |

## 5. INTEREST EXPENSE

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Financial liabilities at amortised cost | | |
| Credit institutions | 777 | 981 |
| Other than credit institutions | 2,547 | 3,453 |
| Debt instruments in issue | 158 | 160 |
| Subordinated liabilities | 76 | 172 |
| Discount amortisation on other provisions (Note: 27) | 3 | 3 |
| Financial liabilities held for trading (Note: 7) | 164 | 694 |
| Derivatives used as economic hedges (Note: 7) | 416 | 562 |
| Derivatives used for hedging (Note: 7) | 724 | 470 |
| | **4,865** | **6,495** |

## 6. NET FEE AND COMMISSION INCOME

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Fee and commission income** | | |
| Payment services | 5,216 | 5,094 |
| Administration of credits | 1,114 | 1,164 |
| Collective investments | 604 | 406 |
| Securities | 196 | 85 |
| Custody | 144 | 157 |
| Asset management | 61 | 73 |
| Other | 462 | 434 |
| | **7,797** | **7,413** |
| **Fee and commission expense** | | |
| Payment services | 1,185 | 960 |
| Retail service fees | 1,101 | 1,045 |
| Commissions to agents | 41 | 47 |
| Other | 467 | 474 |
| | **2,794** | **2,526** |
| **Net fee and commission income** | **5,003** | **4,887** |

## 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) | 2013 | 2012 |
|---|---|---|
| **Net gains from financial instruments at fair value through profit or loss and foreign exchange - as reported** | **2,421** | **2,297** |
| Net interest income (Notes: 4, 5) | 556 | 926 |
| | **2,977** | **3,223** |
| **Financial instruments held for trading and derivatives used for hedging** | | |
| Interest rate contracts | 399 | 626 |
| Foreign exchange | (5,847) | 2,975 |
| Equity contracts | 0 | 20 |
| Commodity contracts | 14 | 16 |
| | (5,434) | 3,637 |
| **Financial instruments designated at fair value through profit or loss** | | |
| Financial assets designated at fair value through profit or loss | 384 | 540 |
| Foreign exchange differences | 8,027 | (954) |
| **Financial instruments at fair value through profit or loss and foreign exchange** | **2,977** | **3,223** |

## 8. OTHER NET INCOME

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Operating leasing and rental income | 152 | 153 |
| Services provided to Československá obchodná banka, a.s (ČSOB SK) | 102 | 111 |
| Net gain on disposal of loans and receivables | 29 | 110 |
| Net gain / (loss) on disposal of Held-to-maturity investments | 10 | (24) |
| Net gain on disposal of non-current assets held-for-sale | 6 | - |
| Net gain / loss on disposal of financial liabilities at amortised cost | 4 | (90) |
| Net gain from the sale of ČSOB Pojišťovna, a.s., a member of the ČSOB holding (Note: 18) | - | 1,271 |
| Net gain from the sale of ČSOB Asset Management, a.s., investment company (Note: 18) | - | 75 |
| Net decrease in provisions for legal issues | - | 21 |
| Other | 500 | 425 |
| | **803** | **2,052** |

## 9. STAFF EXPENSES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Wages and salaries | 4,051 | 4,142 |
| Salaries and other short-term benefits of senior management | 91 | 69 |
| Social security charges | 1,313 | 1,232 |
| Pension and similar expense | 131 | 143 |
| Additions and reversals of provision for Restructuring programme (Note: 27) | (1) | 191 |
| Other | 126 | 123 |
| | **5,711** | **5,900** |

**Management bonus scheme**

Included within Salaries and other short-term benefits of senior 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.

Only the Chairman of the Supervisory Board is remunerated for his membership 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. 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 senior management) with a voluntary defined contribution retirement scheme. Participating employees can contribute 1% or 2% of their salaries mainly to ČSOB Penzijní fond Stabilita, a.s., a wholly-owned subsidiary of ČSOB, and to other pension funds 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. The contributions are from 1 January 2013 as a part of pension reform sent to the newly formed Transformed fund or participation funds managed by ČSOB Penzijní společnost, a. s. or other pension companies.

**Termination benefits**

Employees dismissed by their employer according to the Czech employment law are entitled to termination benefits equal to or less than three times the employees's month's 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 6 to 24 monthly salaries as termination benefits (number of months depends on individual contracts). During 2013 and 2012, no such compensation was paid out.

## 10. GENERAL ADMINISTRATIVE EXPENSES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Rental expenses on information technologies – minimum lease payments | 1,638 | 1,606 |
| Information technologies | 1,079 | 1,115 |
| Deposit insurance premium and contribution to the Securities Traders Guarantee Fund | 821 | 795 |
| Rental expenses on land and buildings – minimum lease payments | 656 | 679 |
| Marketing | 515 | 616 |
| Other building expenses | 509 | 497 |
| Professional fees | 374 | 401 |
| Communication | 325 | 376 |
| Retail service fees | 174 | 140 |
| Travel and transportation | 127 | 121 |
| Administration | 113 | 118 |
| Payment cards and electronic banking | 111 | 234 |
| Training | 68 | 99 |
| Car expenses | 54 | 56 |
| Insurance | 39 | 37 |
| Other | 355 | 380 |
| | **6,958** | **7,270** |

## 11. IMPAIRMENT LOSSES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Impairment of loans and receivables (Notes: 17, 31) | (487) | (609) |
| Provisions for loan commitments and guarantees (Notes: 27, 31) | 18 | 57 |
| Impairment of available-for-sale financial assets (Notes: 16, 29, 31) | - | (23) |
| Impairment of investments in subsidiaries, associates and joint ventures (Notes: 18, 31) | (70) | (205) |
| Impairment of property and equipment (Notes: 20, 31) | (50) | (12) |
| Impairment of non-current assets held-for-sale (Notes: 22, 31) | (7) | - |
| Impairment of other assets (Note: 31) | 1 | 288 |
| | **(595)** | **(504)** |

## 12. TAXATION

The components of income tax expense for the years ended 31 December 2013 and 2012 are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Current tax expense | 1,485 | 1,205 |
| Net provisions for tax disputes | - | (199) |
| Previous year over accrual of current tax | (41) | (480) |
| Deferred tax expense relating to the origination and reversal of temporary differences | 13 | 696 |
| | **1,457** | **1,222** |

A reconciliation between the tax expense and the accounting profit multiplied by the domestic tax rate for the years ended 31 December 2013 and 2012 is as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Profit before taxation | 15,791 | 16,901 |
| Applicable tax rates | 19% | 19% |
| | | |
| Taxation at applicable tax rates | 3,000 | 3,211 |
| Net provisions for tax disputes | - | (199) |
| Previous year over accrual of current tax | (41) | (480) |
| Previous year under accrual of deferred tax | - | 610 |
| Tax effect of non-taxable income | (1,649) | (2,185) |
| Tax effect of non-deductible expenses | 147 | 263 |
| Other | - | 2 |
| | **1,457** | **1,222** |

The applicable tax rate for 2013 was 19% (2012: 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) | 2013 | 2012 |
|---|---|---|
| **At 1 January** | **(468)** | **1,415** |
| | | |
| Statement of income | (13) | (696) |
| Available-for-sale securities (Note: 29) | | |
| Fair value remeasurement | (839) | (697) |
| Transfer to net profit | 95 | (26) |
| Cash-flow hedges (Note: 29) | | |
| Fair value remeasurement | 194 | (443) |
| Transfer to net profit | 40 | (21) |
| **At 31 December** | **(991)** | **(468)** |

Deferred tax assets / (liability) are attributable to the following items:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Deferred tax assets / (liability)** | | |
| Employee benefits | 279 | 195 |
| Accelerated tax depreciation | 255 | 246 |
| Provisions | 115 | 132 |
| Loans and receivables - bonds reclassified from Available-for-sale securities (Note: 16) | 86 | - |
| Legal claim | 72 | 131 |
| Allowances for credit losses | 60 | 55 |
| Impairment losses on financial investments | 26 | 38 |
| Held-to-maturity investments - bonds reclassified from Available-for-sale securities (Note: 16) | (208) | - |
| Amortisation of goodwill | (369) | (338) |
| Cash-flow hedges | (596) | (830) |
| Available-for-sale securities | (724) | (102) |
| Other temporary differences | 13 | 5 |
| | **(991)** | **(468)** |

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

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Employee benefits | 84 | (52) |
| Accelerated tax depreciation | 9 | 24 |
| Allowances for credit losses | 5 | (12) |
| Impairment losses on financial investments | (12) | (626) |
| Provisions | (17) | 13 |
| Amortisation of goodwill | (31) | (36) |
| Legal claim | (59) | (3) |
| Other temporary differences | 8 | (4) |
| | **(13)** | **(696)** |

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

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 2013 has not been taken before the date of issue of the financial statements.

Based on a sole shareholder decision from 28 June 2013, a dividend of CZK 45.50 per share was paid for 2012, representing a total dividend of CZK 13,320 m.

Based on a sole shareholder decision from 26 June 2012, a dividend of CZK 22.53 per share was paid for 2011, representing a total dividend of CZK 6,596 m.

## 14. CASH AND BALANCES WITH CENTRAL BANKS

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Cash (Note: 31) | 9,934 | 9,046 |
| Mandatory minimum reserves (Notes: 32, 38.2) | 8,456 | 8,776 |
| Reverse repo transactions (Notes: 31, 32, 38.2) | 32,000 | 7,500 |
| Other balances with central banks (Notes: 31, 32, 38.2) | 2,301 | 1,755 |
| | **52,691** | **27,077** |

Mandatory minimum reserves are not available for use in the Bank's day-to-day operations.

The Czech National Bank (CNB) pays interest on the mandatory minimum reserve balances based on the official CNB two-week repo rate.

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

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Financial assets held for trading** | | |
| Loans and advances | | |
| Reverse repo transactions (Note: 34) | 139,864 | 95,819 |
| Money market placements | 19,567 | 15,967 |
| Debt instruments | | |
| Central government | 27,878 | 29,504 |
| Non credit institutions | 8 | 21 |
| Credit institutions | 6,024 | 5,005 |
| Corporate | 329 | 1,197 |
| Derivative contracts (Note: 19) | | |
| Trading derivatives | 11,855 | 14,029 |
| Derivatives used as economic hedges | 515 | 1,677 |
| | **206,040** | **163,219** |
| **Financial assets designated at fair value through profit or loss** | | |
| Debt instruments | | |
| Non credit institutions | 425 | 397 |
| Credit institutions | 8,118 | 7,970 |
| | **8,543** | **8,367** |
| **Financial assets at fair value through profit or loss** | **214,583** | **171,586** |

Included within Financial assets at fair value through profit or loss are debt securities of CZK 9,163 m (2012: CZK 2,407 m) pledged as collateral in repo transactions.

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 bases.

## 16. FINANCIAL INVESTMENTS

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Available-for-sale financial assets** | | |
| Debt securities | | |
| Central government | 28,837 | 40,600 |
| Non credit institutions | 846 | - |
| Credit institutions | 37,092 | 97,919 |
| Corporate | 2,179 | 2,012 |
| Equity securities | | |
| Corporate | 627 | 481 |
| | **69,581** | **141,012** |
| **Held-to-maturity investments** | | |
| Debt securities | | |
| Central government | 143,357 | 129,867 |
| Non credit institutions | - | 519 |
| Credit institutions | 1,918 | 2,184 |
| Corporate | 192 | 99 |
| | **145,467** | **132,669** |
| **Financial investments** | **215,048** | **273,681** |

Included within Financial investments are debt securities of CZK 31,501 m (2012: CZK 8,307 m) pledged as collateral in repo transactions and debt securities of CZK 5,330 m (2012: CZK 1,766 m) pledged as collateral of term deposits and financial guarantees.

In February 2012, an agreement on the key terms of the voluntary exchange of Greek government bonds held by the private sector was reached in the European Union. Based on the decision of the Bank to accede to the agreement, the Bank derecognised the entire amount of old Greek bonds and realised a loss in the amount of CZK 412 m reported under Net realised gains on available-for-sale financial assets in the statement of income.

Just after the derecognition of the old Greek bonds, new financial instruments were recognised along with the key terms of the agreement. 15% of the principal of the old Greek bonds was exchanged for short-term securities issued by the European Financial Stability Facility (EFSF) and 31.5% was converted into 20 new tranches of coupon bonds issued by the Greek government and Greek GDP-linked securities. Interest income, which was accrued on the old Greek bonds but was not paid by the date of the exchange, was replaced by short-term EFSF notes.

On 30 March 2012, the new debt instruments in the total carrying amount of CZK 1,115 m were sold to KBC Credit Investments NV. No debt instruments issued by Greek government were held by the Bank as at 31 December 2012 (Note: 36).

Due to a deterioration in the issuers' credibility, the Bank decided to gradually sell the portfolio of bonds issued by the Italian and Spanish government classified as Held-to-maturity investments. Following the decision, Italian bonds in the amount of CZK 975 m were sold in the end of 2011. The remaining position of the Italian and Spanish sovereign bonds in the amount of CZK 1,499 m was sold in 2012. All these sales are considered by the Bank as insignificant in relation to the entire Held-to-maturity portfolio.

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 the interest income over the remaining maturity of the bonds (2012: CZK 1,412 m; 2011: CZK 471 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 the 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; 2011: CZK 6,212 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:

| | 2013 | |
|---|---|---|
| (CZKm) | Carrying value | Fair value |
| **Financial assets** | | |
| Held-to-maturity investments | 14,001 | 14,675 |
| Loans and receivables | 62,762 | 59,232 |

The following table shows the total fair value gain or loss in Statement comprehensive income that would have been recognised during 2013 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 actually been recorded in the financial statements:

| (CZKm) | Debt sovereign bonds | Mortgage bonds | Total |
|---|---|---|---|
| Net gain / (loss) on Available-for-sale assets (before tax) | 674 | (3,530) | (2,856) |

The following table shows the net profit or loss actually recorded on reclassified assets in 2013 after date of reclassification:

| (CZKm) | Debt sovereign bonds | Mortgage bonds | Total |
|---|---|---|---|
| Interest income (before tax) | 256 | 402 | 658 |

The following table shows the expected undiscounted cash recoveries, as assessed at the date of reclassification and anticipated average 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% | |

The following table shows a reconciliation of the cumulative impairment losses on financial investments for 2012 and 2013:

| | Available-for-sale financial assets | | Total |
|---|---|---|---|
| (CZKm) | Debt securities | Equity securities | |
| **At 1 January 2012** | **3,317** | **92** | **3,409** |
| Increase (Note: 11) | - | 23 | 23 |
| Utilisation | (3,162) | - | (3,162) |
| Foreign currency translation | (155) | 1 | (154) |
| **At 31 December 2012** | **-** | **116** | **116** |
| Utilisation | - | (37) | (37) |
| **At 31 December 2013** | **-** | **79** | **79** |

## 17. LOANS AND RECEIVABLES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Analysed by category of borrower** | | |
| Central government | 466 | 293 |
| Non credit institutions | 7,017 | 6,546 |
| Credit institutions | 169,877 | 93,018 |
| Other legal entities | 176,141 | 164,356 |
| Private individuals | 38,076 | 36,370 |
| Gross loans | 391,577 | 300,583 |
| Allowance for impairment losses | (6,954) | (7,435) |
| | **384,623** | **293,148** |

The following tables show a reconciliation of the allowances for impairment losses on loans and receivables for 2012 and 2013 by classes of financial instruments and by individual and collective impairment:

| (CZKm) | Non credit institutions | Credit institutions | Other legal entities | Private individuals | Total |
|---|---|---|---|---|---|
| **At 1 January 2012** | **-** | **217** | **6,489** | **1,527** | **8,233** |
| Net increase in allowances for credit losses (Note: 11) | 1 | (10) | 131 | 487 | 609 |
| Write-offs | - | - | (963) | (419) | (1,382) |
| Foreign currency translation | - | (1) | (24) | - | (25) |
| **At 31 December 2012** | **1** | **206** | **5,633** | **1,595** | **7,435** |
| Net increase in allowances for credit losses (Note: 11) | 1 | (198) | 129 | 555 | 487 |
| Write-offs | - | - | (426) | (577) | (1,003) |
| Foreign currency translation | - | - | 33 | 2 | 35 |
| **At 31 December 2013** | **2** | **8** | **5,369** | **1,575** | **6,954** |

| (CZKm) | Individual impairment | Collective impairment | Total |
|---|---|---|---|
| **At 1 January 2012** | **7,882** | **351** | **8,233** |
| Increase in allowances for credit losses (Note: 11) | 1,760 | 65 | 1,825 |
| Decrease in allowances for credit losses (Note: 11) | (1,089) | (127) | (1,216) |
| Write-offs | (1,382) | - | (1,382) |
| Foreign currency translation | (25) | - | (25) |
| **At 31 December 2012** | **7,146** | **289** | **7,435** |
| Increase in allowances for credit losses (Note: 11) | 1,597 | 110 | 1,707 |
| Decrease in allowances for credit losses (Note: 11) | (1,139) | (81) | (1,220) |
| Write-offs | (1,003) | - | (1,003) |
| Foreign currency translation | 35 | - | 35 |
| **At 31 December 2013** | **6,636** | **318** | **6,954** |

## 18. INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

Direct ownership of the Bank (%) in significant subsidiaries, associates and joint ventures was as follows:

| | | 2013 | | 2012 | |
|---|---|---|---|---|---|
| Name | Abbreviation | (%) | Carrying amount | (%) | Carrying amount |
| **Subsidiaries** | | | | | |
| Bankovní informační technologie, s.r.o. | BANIT | 100.00 | 30 | 100.00 | 30 |
| Centrum Radlická a.s. | Centrum Radlická | 100.00 | 709 | 100.00 | 709 |
| ČSOB Advisory, a.s. (formerly ČSOB IBS) | ČSOB Advisory | 100.00 | 1,858 | 100.00 | 1,858 |
| ČSOB Factoring, a.s. | ČSOB Factoring | 100.00 | 1,175 | 100.00 | 1,175 |
| ČSOB Leasing, a.s. | ČSOB Leasing | 100.00 | 4,100 | 100.00 | 4,100 |
| ČSOB Penzijní fond Stabilita, a.s., a member of the ČSOB Group | ČSOB PF Stabilita | - | - | 100.00 | 1,357 |
| ČSOB Penzijní společnost, a. s., a member of the ČSOB group | ČSOB PS | 100.00 | 1,318 | - | - |
| ČSOB Property fund, closed-ended investment fund, a.s., a member of the ČSOB group | ČSOB Property fund | 59.79 | 281 | 59.79 | 312 |
| Hypoteční banka, a.s. | Hypoteční banka | 100.00 | 25,130 | 100.00 | 25,130 |
| **Joint venture** | | | | | |
| Českomoravská stavební spořitelna, a.s. | ČMSS | 55.00 | 1,540 | 55.00 | 1,540 |
| **Associate** | | | | | |
| ČSOB Asset Management, a.s., investment company | ČSOB AM/IS | 40.08 | 100 | 40.08 | 127 |
| ČSOB Pojišťovna, a. s., a member of the ČSOB holding | ČSOB Pojišťovna | 0.24 | 9 | 0.24 | 9 |
| | | | **36,250** | | **36,347** |

All companies are incorporated in the Czech Republic.

On 1 January 2013, new legislation introducing reforms to the pension fund system within the Czech Republic became effective. Accordingly, the net assets of the ČSOB PF Stabilita were split to the group of net assets of pension fund shareholders forming the pension fund management company ČSOB Penzijní společnost, a. s., a member of the ČSOB group and to the group of net assets of pension scheme participants forming the Transformovaný fond Stabilita ČSOB Penzijní společnosti, a.s., a member of the ČSOB Group (Transformed fund) (as part of Pillar III), which is closed to new participants. ČSOB PS is responsible for management of the Transformed fund. This company is entitled to up to 15% of the profits of the Transformed fund in addition to a regular assets management fee and needs to guarantee the positive results and equity position of the Transformed fund. As a result ČSOB PS retains control over the Transformed fund.

In December 2012, a redemption of the share premium from ČSOB Leasing in the amount of CZK 1,500 m was processed.

In November 2012, ČSOB sold 24.76% of its ownership in ČSOB Pojišťovna to KBC Insurance NV. The sale did not affect the significant influence of the Bank over the ČSOB Pojišťovna as 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 from now on. Thus, ČSOB Pojišťovna is still assessed to be an associated company of the Bank (Notes: 8, 22, 36).

In June and October 2012, based on the Sole shareholder decision, the Bank increased the share premium of Hypoteční banka by CZK 2,605 m and the statutory reserve of Hypoteční banka by CZK 495 m.

In May 2012, ČSOB Investment Banking Services, a.s., a member of the ČSOB group (ČSOB IBS) was renamed to ČSOB Advisory, a.s. In June 2012, a redemption of the share premium from ČSOB Advisory in the amount of CZK 600 m was processed. In October 2012, Auxilium merged with ČSOB Advisory. ČSOB Advisory being the successor company. In December 2012, a redemption of the other capital funds from ČSOB Advisory in the amount of CZK 1,000 m was processed.

In May 2012, a redemption of the share premium from Centrum Radlická in the amount of CZK 260 m was processed.

Starting in January 2012, as a result of the merger of ČSOB Investiční společnost, a.s., a member of the ČSOB group and ČSOB Asset Management, a.s., a member of the ČSOB group and the effective date of the registration, the Bank effectively lost control over the merged ČSOB AM/IS. In November 2012, the Bank sold 21 shares of ČSOB AM/IS to KBC Participations Renta C, SA to achieve a target share of ČSOB Group on the equity of ČSOB AM/IS of 40.08% (Notes: 8, 22, 36).

In July 2013, a redemption of the other capital funds from ČSOB AM/IS in the amount of CZK 27 m was processed.

The Bank is entitled to exercise 50.82% of the voting rights in ČSOB Leasing, since remaining 49.18% of the voting rights were transferred to the KBC Lease Holding NV.

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. In 2012, the participation of the Bank in ČSOB Property fund increased as a result of the Bank's decision to decrease the amount of the share capital of the entity and buyout of shares.

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 2012 and 2013, the Bank considered the value of interests in certain subsidiaries to be impaired.

In December 2013 and 2012 the value of interests in ČSOB PF Stabilita / ČSOB PS 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 39 m and CZK 190 m, respectively, has been recognised.

In December 2013 and 2012 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 31 m and CZK 15 m. respectively, 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 2012 and 2013:

| (CZKm) | ČSOB PF Stabilita / ČSOB PS | ČSOB Property fund | Total |
|---|---|---|---|
| **At 1 January 2012** | **379** | **205** | **584** |
| Increase (Note: 11) | 190 | 15 | 205 |
| Utilisation | - | (7) | (7) |
| **At 31 December 2012** | **569** | **213** | **782** |
| Increase (Note: 11) | 39 | 31 | 70 |
| **At 31 December 2013** | **608** | **244** | **852** |

## 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 2013 and 2012 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***

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 440,632 | 7,478 | 9,607 | 380,667 | 12,318 | 14,541 |
| Forwards | 52,985 | 14 | 3 | 34,514 | 16 | 18 |
| Options | 31,922 | 198 | 250 | 31,727 | 264 | 339 |
| | **525,539** | **7,690** | **9,860** | **446,908** | **12,598** | **14,898** |
| **Foreign exchange contracts** | | | | | | |
| Swaps / Forwards | 96,759 | 1,790 | 527 | 106,961 | 594 | 743 |
| Cross currency interest rate swaps | 94,657 | 2,078 | 2,829 | 65,348 | 599 | 379 |
| Options | 13,928 | 192 | 197 | 12,022 | 112 | 113 |
| | **205,344** | **4,060** | **3,553** | **184,331** | **1,305** | **1,235** |
| **Commodity contracts** | | | | | | |
| Swaps / Options | 7,650 | 105 | 97 | 7,273 | 126 | 116 |
| **Total trading derivatives (Notes: 15, 24)** | **738,533** | **11,855** | **13,510** | **638,512** | **14,029** | **16,249** |

***Positions of ALM – economic hedges***

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 44,643 | 124 | 458 | 58,524 | 699 | 1,593 |
| Forwards | 501 | - | - | - | - | - |
| **Foreign exchange contracts** | | | | | | |
| Cross currency interest rate swaps | 18,059 | 391 | 869 | 20,918 | 978 | 123 |
| **Total derivatives used as economic hedges (Notes: 15, 24)** | **63,203** | **515** | **1,327** | **79,442** | **1,677** | **1,716** |

**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). The Bank stopped applying cash flow hedge accounting of a group of term deposits denominated in CZK using the CZK single currency swaps at the end of November 2012. The main reasons for the cessation of the cash flow hedge were a significant decline of the volume of eligible term deposits during the previous periods and a forecasted further decrease in their volume. The hedge was reconsidered to be prospectively ineffective.
- 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 / floating rate subordinated debt** to fixed rates. In August 2013, the Bank redeemed its subordinated debt and terminated related interest rate swaps used to hedge interest rate risk arising from variability of interest paid on the subordinated debt (Note: 25).

Cross currency interest rate swaps (fix-to-fix or floating-to-fix) 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 2013 and 2012 are set out as follows:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Cash flow hedges** | | | | | | |
| Single currency interest rate swaps | 139,268 | 7,042 | 3,837 | 154,269 | 9,780 | 5,359 |
| Cross currency interest rate swaps | 22,605 | 1,158 | 1,171 | 24,179 | 2,564 | 236 |
| **Total hedging derivatives** | **161,873** | **8,200** | **5,008** | **178,448** | **12,344** | **5,595** |

Net gains and losses on cash flow hedges reclassified to the statement of income are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Interest income (Note: 29) | 246 | 153 |
| Net losses from financial instruments at fair value through profit or loss (Note: 29) | (33) | (263) |
| Taxation (Note: 12) | (40) | 21 |
| **Net gains / (losses)** | **173** | **(89)** |

In 2013, a loss of CZK 20 m was recognised in the statement of income due to hedge ineffectiveness from cash flow hedges (2012: gain of CZK 10 m).

In 2013 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 losses of CZK 13 m from equity to the statement of income (2012: CZK 273 m). The losses were 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 hedging derivatives.

The following table shows the notional amounts of hedging derivatives by remaining contractual maturity at 31 December 2013 and 2012:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Less than 3 months | 3,726 | 5,171 |
| More than 3 months but not more than 6 months | 16,667 | 9,529 |
| More than 6 months but not more than 1 year | 23,413 | 21,402 |
| More than 1 year but not more than 2 years | 15,462 | 44,522 |
| More than 2 years but not more than 5 years | 54,876 | 42,603 |
| More than 5 years | 47,729 | 55,221 |
| | **161,873** | **178,448** |

**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.

From March 2009, 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.

From August 2011, 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.

From August 2011, fair value hedges for **portfolios of fixed rate loans** have been used to hedge interest rate risk arising from changes in 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.

From July 2012, new 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 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.

From November 2012, 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 2013 and 2012 are set out as follows:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Fair value hedges** | | | | | | |
| *Single currency interest rate swaps* | | | | | | |
| Fair value micro hedges | 21,335 | 212 | 1,756 | 17,804 | - | 1,553 |
| Fair value portfolio hedges | 158,193 | 873 | 2,014 | 93,998 | 1,993 | 1,443 |
| *Cross currency interest rate swaps* | | | | | | |
| Fair value micro hedges | 5,935 | - | 314 | 5,418 | 115 | 61 |
| **Total hedging derivatives** | **185,463** | **1,085** | **4,084** | **117,220** | **2,108** | **3,057** |

In 2013, the net gains in the amount of CZK 874 m (2012: net losses of CZK 223 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 losses realised on the hedging contracts, which are included in Net gains from financial instruments at fair value through profit or loss, amounted to CZK 1,020 m (2012: net gains of CZK 177 m).

## 20. PROPERTY AND EQUIPMENT

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2012 | 5,265 | 138 | 559 | 1,342 | 19 | 7,323 |
| Depreciation and impairment at 1 January 2012 | (2,354) | (122) | (398) | (892) | - | (3,766) |
| **Net book value at 1 January 2012** | **2,911** | **16** | **161** | **450** | **19** | **3,557** |
| Transfers | 267 | - | 24 | 156 | (447) | - |
| Additions | - | - | - | - | 465 | 465 |
| Disposals | (2) | (3) | (1) | (3) | - | (9) |
| Depreciation | (229) | (8) | (30) | (113) | - | (380) |
| Impairment (Note: 11) | (10) | - | - | (2) | - | (12) |
| **Net book value at 31 December 2012** | **2,937** | **5** | **154** | **488** | **37** | **3,621** |
| of which | | | | | | |
| Cost | 5,514 | 130 | 573 | 1,398 | 37 | 7,652 |
| Depreciation and impairment | (2,577) | (125) | (419) | (910) | - | (4,031) |

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2013 | 5,514 | 130 | 573 | 1,398 | 37 | 7,652 |
| Depreciation and impairment at 1 January 2013 | (2,577) | (125) | (419) | (910) | - | (4,031) |
| **Net book value at 1 January 2013** | **2,937** | **5** | **154** | **488** | **37** | **3,621** |
| Transfers | 94 | 3 | 22 | 74 | (193) | - |
| Additions | - | - | - | - | 248 | 248 |
| Disposals | (182) | - | (1) | - | - | (183) |
| Depreciation | (232) | (4) | (31) | (116) | - | (383) |
| Transfer to non-current assets held-for-sale | (27) | - | - | - | - | (27) |
| Impairment (Note: 11) | (50) | - | - | - | - | (50) |
| **Net book value at 31 December 2013** | **2,540** | **4** | **144** | **446** | **92** | **3,226** |
| of which | | | | | | |
| Cost | 5,341 | 130 | 576 | 1,484 | 92 | 7,623 |
| Depreciation and impairment | (2,801) | (126) | (432) | (1,038) | - | (4,397) |

## 21. GOODWILL AND OTHER INTANGIBLE ASSETS

| (CZKm) | Goodwill | Software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|
| Cost at 1 January 2012 | 2,752 | 3,145 | 729 | 5 | 6,631 |
| Amortisation and impairment at 1 January 2012 | (63) | (3,067) | (634) | - | (3,764) |
| **Net book value at 1 January 2012** | **2,689** | **78** | **95** | **5** | **2,867** |
| Transfers | - | - | 20 | (20) | - |
| Additions | - | - | - | 16 | 16 |
| Amortisation | - | (63) | (59) | - | (122) |
| **Net book value at 31 December 2012** | **2,689** | **15** | **56** | **1** | **2,761** |
| of which | | | | | |
| Cost | 2,752 | 3,145 | 747 | 1 | 6,645 |
| Amortisation and impairment | (63) | (3,130) | (691) | - | (3,884) |

| (CZKm) | Goodwill | Software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|
| Cost at 1 January 2013 | 2,752 | 3,145 | 747 | 1 | 6,645 |
| Amortisation and impairment at 1 January 2013 | (63) | (3,130) | (691) | - | (3,884) |
| **Net book value at 1 January 2013** | **2,689** | **15** | **56** | **1** | **2,761** |
| Transfers | - | 2 | 23 | (25) | - |
| Additions | - | - | - | 24 | 24 |
| Disposals | - | - | (6) | - | (6) |
| Amortisation | - | (17) | (51) | - | (68) |
| **Net book value at 31 December 2013** | **2,689** | **-** | **22** | **-** | **2,711** |
| of which | | | | | |
| Cost | 2,752 | 3,148 | 748 | - | 6,648 |
| Amortisation and impairment | (63) | (3,148) | (726) | - | (3,937) |

Goodwill has been allocated to the Retail / SME segment, representing a cash-generating unit (CGU). The recoverable amount for the Retail / SME segment was determined based on the value-in-use methodology. The calculation uses cash flow projections from business plans for the forthcoming three 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 / SME segment are based on 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 9.0% in 2013 (2012: 10.0%) and no long term growth rates were used in 2013 and 2012.

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 / SME has been used for extrapolation purposes beyond the budget period.
- The risk discount rate. For Retail / SME a risk discount rate of 9.0% in 2013 (2012: 10.0%) has been applied. 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 / SME segment 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 | ČSOB Pojišťovna | ČSOB AM/IS | Total |
|---|---|---|---|---|
| **Net book value at 1 January 2012** | **-** | **-** | **-** | **-** |
| Transfer from Investments in subsidiaries, associates and joint ventures | - | 907 | 13 | 920 |
| Disposals | - | (907) | (13) | (920) |
| **Net book value at 31 December 2012** | **-** | **-** | **-** | **-** |
| of which | | | | |
| Cost | - | - | - | - |
| Impairment | - | - | - | - |

| (CZKm) | Land and buildings | ČSOB Pojišťovna | ČSOB AM/IS | Total |
|---|---|---|---|---|
| **Net book value at 1 January 2013** | **-** | **-** | **-** | **-** |
| Transfer from Property and equipment | 27 | - | - | 27 |
| Impairment (Note: 11) | (7) | - | - | (7) |
| **Net book value at 31 December 2013** | **20** | **-** | **-** | **20** |
| of which | | | | |
| Cost | 27 | - | - | 27 |
| Impairment | (7) | - | - | (7) |

Movement disclosed in Transfer and Disposals represents part of the investments in ČSOB Pojišťovna and ČSOB AM/IS which were sold to KBC Insurance NV and KBC Participations Renta C, SA respectively in November 2012 (Note: 18).

## 23. OTHER ASSETS

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Other debtors, net of provisions (Notes: 30, 32, 35, 38.2) | 599 | 667 |
| Accrued income (Notes: 30, 32, 35, 38.2) | 324 | 264 |
| Prepaid charges | 195 | 208 |
| Receivables from securities clearing entities (Notes: 30, 32, 35, 38.2) | 35 | 176 |
| VAT and other tax receivables | 7 | 16 |
| | **1,160** | **1,331** |

## 24. FINANCIAL LIABILITIES HELD FOR TRADING

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Short positions | 5,546 | 4,727 |
| Derivative contracts (Note: 19) | | |
| Trading derivatives | 13,510 | 16,249 |
| Derivatives used as economic hedges | 1,327 | 1,716 |
| Term deposits | 64,736 | 11,999 |
| Repo transactions | 102,298 | 96,062 |
| Promissory notes | 80 | 6 |
| Bonds issued | 4,976 | 5,111 |
| **Financial liabilities held for trading** | **192,473** | **135,870** |

## 25. FINANCIAL LIABILITIES AT AMORTISED COST

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Deposits received from credit institutions** | | |
| Current accounts | 18,612 | 12,929 |
| Term deposits | 37,441 | 46,090 |
| Repo transactions | 21,025 | 8,307 |
| | **77,078** | **67,326** |
| **Deposits received from other than credit institutions** | | |
| Current accounts | 294,990 | 280,577 |
| Term deposits | 17,953 | 23,367 |
| Savings deposits | 216,261 | 205,230 |
| Repo transactions | 10,533 | - |
| Other deposits | 3,457 | 5,939 |
| | **543,194** | **515,113** |
| **Debt securities in issue** | | |
| Bonds issued | 1,793 | 1,356 |
| Promissory notes | 14,597 | 16,689 |
| | **16,390** | **18,045** |
| **Subordinated liabilities** | | |
| Subordinated debt | **-** | **7,983** |
| **Financial liabilities at amortised cost** | **636,662** | **608,467** |

In September 2006 and in February 2007, the Bank issued subordinated debt in the nominal amounts of CZK 5,000 m and CZK 7,000 m, respectively to KBC Bank NV. Both subordinated debts were issued with a ten-year maturity. Their coupon rate was set up at PRIBOR + 0.35% (interest period 1M, 3M or 6M at the discretion of the Bank) in the first six year period and PRIBOR + 0.85% (interest period 1M, 3M or 6M at the discretion of the Bank) thereafter. The Bank was allowed to prepay the debt at any time following the first six year period. In September 2012, the Bank prepaid a majority of the first tranche in the amount of CZK 4,000 m. In August 2013, the Bank prepaid the whole remaining balance of the subordinated debt.

## 26. OTHER LIABILITIES

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Other clearing accounts (Notes: 30, 32, 35, 38.3) | 4,181 | 3,858 |
| Payables to employees including social security charges (Notes: 30, 32, 35, 38.3) | 1,855 | 1,791 |
| Accrued charges (Notes: 30, 32, 35, 38.3) | 1,433 | 1,226 |
| Other creditors (Notes: 30, 32, 35, 38.3) | 390 | 466 |
| Income received in advance | 218 | 264 |
| Payables to securities clearing entities (Notes: 30, 32, 35, 38.3) | 193 | 231 |
| VAT and other tax payables | 116 | 195 |
| Other debts to clients (Notes: 30, 32, 35, 38.3) | 15 | 18 |
| Other (Notes: 30, 32, 35, 38.3) | 9 | 16 |
| | **8,410** | **8,065** |

## 27. PROVISIONS

| (CZKm) | Pending legal issues and other losses | Restructuring | Contractual engagements | Loan commitments and guarantees (Note: 33) | Total |
|---|---|---|---|---|---|
| **At 1 January 2013** | **311** | **191** | **85** | **325** | **912** |
| Additions | 4 | - | 16 | 88 | 108 |
| Amounts utilised | - | (93) | (18) | (106) | (217) |
| Unused amounts reversed | - | (1) | - | - | (1) |
| Discount amortisation (Note: 5) | - | - | 3 | - | 3 |
| Foreign currency translation | 1 | - | - | 17 | 18 |
| **At 31 December 2013** | **316** | **97** | **86** | **324** | **823** |

*Restructuring*

During 2012 the Bank started restructuring programme to reduce the total number of personnel by 382, resulting in the creation of a provision of CZK 191 m (Note: 9). In accordance with the program, the number of personnel had been reduced by 263 by the end of 2013. The Bank expects to use the remaining provision of CZK 97 m to cover the costs related to further reductions in the number of personnel in 2014.

*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 2013, the Bank had a provision in the total amount of CZK 316 m. It is expected that the majority of the costs will be probably 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*

ČSOB assumed a number of leasehold property arrangements from Investiční a Poštovní banka, a.s. (IPB) for which, on a net basis, the unavoidable contractual rental costs exceeded normal market rental conditions existing as at 19 June 2000, the date when IPB was acquired by ČSOB. 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 5 years.

ČSOB created a new provision for onerous rental contracts in 2013 and 2012 in the amount of CZK 16 m and 15 m respectively. It is expected that the costs will be incurred over the next 4 years.

## 28. SHARE CAPITAL AND OTHER RESERVES

As at 31 December 2013, the total authorised share capital was CZK 5,855 m (31 December 2012: CZK 5,855 m) and comprised of 292,750,001 ordinary shares with a nominal value of CZK 20 each (31 December 2012: 292,750,000 ordinary shares with a nominal value of CZK 20 each) and is fully paid up.

Based on the resolution of the sole shareholder dated 11 July 2013, ČSOB issued one ordinary share with a nominal value of CZK 20 and with a share premium of CZK 7,999,999,980 (evidenced by an entry in the Register of Companies dated 23 July 2013).

No Treasury shares were held by the Bank at 31 December 2013 and 2012.

On 31 December 2013, the Bank was directly controlled by KBC Bank whose ownership interest in ČSOB was 100% (31 December 2012: 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 2013 and 2012:

| (CZKm) | Available-for-sale reserve | Cash flow hedge reserve | Total |
|---|---|---|---|
| **At 1 January 2012** | **(2,649)** | **1,557** | **(1,092)** |
| Other comprehensive income (Note: 29) | 3,084 | 1,981 | 5,065 |
| **At 31 December 2012** | **435** | **3,538** | **3,973** |
| Other comprehensive income (Note: 29) | 3,172 | (999) | 2,173 |
| **At 31 December 2013** | **3,607** | **2,539** | **6,146** |

## 29. COMPONENTS OF OTHER COMPREHENSIVE INCOME

| (CZKm) | 2013 | 2012 |
|---|---|---|
| **Cash flow hedges** | | |
| Net unrealised (losses) / gains on cash flow hedges | (1,020) | 2,335 |
| Net (gains) / losses on cash flow hedges reclassified to the statement of income (Note: 19) | (213) | 110 |
| Tax effect relating to cash flow hedges (Note: 12) | 234 | (464) |
| | (999) | 1,981 |
| **Available-for-sale financial assets** | | |
| Net unrealised gains on available-for-sale financial investments | 4,406 | 3,648 |
| Net realised (gains) / losses on available-for-sale financial investments reclassified to the statement of income on disposal | (352) | 136 |
| Net realised gains on available-for-sale financial investments amortised to the statement of income on reclassified assets (Note: 16) | (138) | - |
| Net realised losses on available-for-sale financial investments reclassified to the statement of income on impairment (Note: 11) | - | 23 |
| Tax effect relating to available-for-sale financial investments (Note: 12) | (744) | (723) |
| | 3,172 | 3,084 |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | **2,173** | **5,065** |

## 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 and foreign exchange 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 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 and retained interests in securitisations. 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 approval of any new product consist also from assessment of valuation of the product and eventual new valuation model for the product has to be approved before the product is endorsed or approval of the model is blocking condition for the product implementation. The New and Active Product Process also requires regular review of all products and assessment of valuation quality is the 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 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 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 2013:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | 159,431 | - | 159,431 |
| Debt instruments | 21,512 | 6,293 | 6,434 | 34,239 |
| Derivative contracts | - | 12,370 | - | 12,370 |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | 862 | 2,924 | 4,757 | 8,543 |
| Available-for-sale financial assets | | | | |
| Debt securities | 29,974 | 31,857 | 7,123 | 68,954 |
| Equity securities | - | - | 627 | 627 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 927 | - | 927 |
| Derivatives used for hedging | - | 9,285 | - | 9,285 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 5,546 | - | - | 5,546 |
| Derivative contracts | - | 14,837 | - | 14,837 |
| Term deposits | - | 64,736 | - | 64,736 |
| Repo transactions | - | 102,298 | - | 102,298 |
| Promissory notes | - | 80 | - | 80 |
| Bonds issued | - | 4,976 | - | 4,976 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (57) | - | (57) |
| Derivatives used for hedging | - | 9,092 | - | 9,092 |

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 2012:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | 111,786 | - | 111,786 |
| Debt instruments | 15,491 | 13,410 | 6,826 | 35,727 |
| Derivative contracts | - | 15,706 | - | 15,706 |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | 818 | 3,035 | 4,514 | 8,367 |
| Available-for-sale financial assets | | | | |
| Debt securities | 41,648 | 33,800 | 65,083 | 140,531 |
| Equity securities | 116 | - | 365 | 481 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 1,030 | - | 1,030 |
| Derivatives used for hedging | - | 14,452 | - | 14,452 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 4,727 | - | - | 4,727 |
| Derivative contracts | - | 17,965 | - | 17,965 |
| Term deposits | - | 11,999 | - | 11,999 |
| Repo transactions | - | 96,062 | - | 96,062 |
| Promissory notes | - | 6 | - | 6 |
| Bonds issued | - | 5,111 | - | 5,111 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 1,741 | - | 1,741 |
| Derivatives used for hedging | - | 8,652 | - | 8,652 |

Until December 2012, the pricing of mortgage bonds was based on CZK government bonds yield and interest rates of interest rate swaps (IRS). Yield curves for estimating future cash flows of mortgage bonds with variable coupon were derived from IRS rates provided by KBC Bank. Yield curves for discounting the estimated future cash flows were based on the yield curve derived from CZK government bonds. As there has been no active market for mortgage bonds in the Czech Republic, estimation of any additional credit spread has been subject to management judgement.

Since December 2012, following the management's analysis of the 2012 market for mortgage bonds characteristics, a new valuation model for mortgage bonds has been implemented. Yield curves used in the model for discounting future cash flows curves are constructed from IRS rates and respective credit spreads. The credit spreads are derived from available market quotes of mortgage bonds and IRS rates. Yield curves for estimating future cash flows of mortgage bonds with variable coupon are still derived from IRS rates provided by KBC Bank.

The spreads for the first five years of maturity are exclusively derived from market observable quotes of mortgage bonds (the management also validates these quotes by comparison to prices reached in observed market transactions). Therefore mortgage bonds with a maturity of up to five years are included in level 2. The spread for the rest of the curve is derived from observed mortgage bond spread at 5 and 10 years and the 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 5 years were transferred to Level 3, which was the main factor contributing to the Level 3 increase in 2012. The spread according to bond maturity was 65 bps (6-year) to 138 bps (above 25-year) in 2012 and 65 bps (6-year) to 111 bps (above 25-year) in 2013.

As a result of the implementation of the new valuation model in 2012, the Bank has recorded unrealised losses of CZK 287 m into the Net gains from financial instruments at fair value through profit or loss and CZK 4 762 m into the Available-for-sale reserve.

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:

| | Financial assets held for trading | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets | | Total |
|---|---|---|---|---|---|
| (CZKm) | Debt securities | Debt securities | Debt securities | Equity securities | |
| **At 1 January 2012** | **-** | **-** | **-** | **144** | **144** |
| Total gains / (losses) recorded in profit or loss | - | - | - | 83 | 83 |
| Total gains / (losses) recorded in other comprehensive income | - | - | - | 253 | 253 |
| Transfers into level 3 | 6,826 | 4,514 | 65,083 | - | 76,423 |
| Sales | - | - | - | (115) | (115) |
| **At 31 December 2012** | **6,826** | **4,514** | **65,083** | **365** | **76,788** |
| Total gains or (losses) recorded in profit or loss related to assets held at the end of the reporting period | (64) | 124 | - | (23) | 37 |
| **At 1 January 2013** | **6,826** | **4,514** | **65,083** | **365** | **76,788** |
| Total gains / (losses) recorded in profit or loss | 344 | 284 | 238 | 70 | 936 |
| Total gains / (losses) recorded in other comprehensive income | - | - | 4,055 | 80 | 4,135 |
| Transfers into level 3 | 210 | - | - | - | 210 |
| Transfers out of level 3 | (392) | - | - | - | (392) |
| Transfers from Available-for-sale to Loans and receivables | - | - | (62,978) | - | (62,978) |
| Purchases | 4,878 | - | 1,254 | 186 | 6,318 |
| Settlement | (597) | - | - | - | (597) |
| Sales | (4,835) | (41) | (529) | (74) | (5,479) |
| **At 31 December 2013** | **6,434** | **4,757** | **7,123** | **627** | **18,941** |
| Total gains or (losses) recorded in profit or loss related to assets held at the end of the reporting period | 286 | 284 | - | - | **570** |

Total gains or (losses) 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 / (losses) on available-for-sale financial assets and Impairment losses 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 credit spread included in the discount factor applied on estimated future cash flows from the mortgage bonds in periods after fifth year 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 2013, an increase / (decrease) of a credit spread by 50 basis points would (decrease) / increase the fair value of the mortgage bonds included in level 3 by CZK 141 m (2012: CZK 590 m). Sensitivity has decreased due to reclassification of mortgage bonds from Available-for-sale financial assets to Loans and receivables (Note: 16) in 2013. Such a change of the credit spread is based on the variability of mortgage 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:

| | Transfers from Level 1 to Level 2 | | Transfers from Level 2 to Level 1 | |
|---|---|---|---|---|
| (CZKm) | 2013 | 2012 | 2013 | 2012 |
| **Financial assets** | | | | |
| Financial assets held for trading | | | | |
| Debt instruments | - | 351 | - | - |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | - | 3,078 | - | - |
| Available-for-sale financial assets | | | | |
| Debt securities | - | 8,515 | - | - |

In 2012, transfers of debt instruments included in Financial assets designated at fair value through profit or loss and Available-for-sale financial assets from level 1 to level 2 represent mortgage bonds, for which the market became illiquid.

**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:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| (CZKm) | Carrying value | Fair value | Carrying value | Fair value |
| **Financial assets** | | | | |
| Cash and balances with central banks | 52,691 | 52,691 | 27,077 | 27,077 |
| Loans and receivables | 384,623 | 387,106 | 293,148 | 298,646 |
| Held-to-maturity investments | 145,467 | 161,439 | 132,669 | 153,290 |
| Other assets (Note: 23) | 958 | 958 | 1,107 | 1,107 |
| **Financial liabilities** | | | | |
| Financial liabilities at amortised cost | 636,662 | 640,506 | 608,467 | 613,574 |
| Other liabilities (Note: 26) | 8,076 | 8,076 | 7,606 | 7,606 |

The following table shows an analysis of financial instruments for which fair value 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 2013:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets for which fair values are disclosed** | | | | |
| Cash and balances with central banks | - | 52,691 | - | 52,691 |
| Loans and receivables | - | 16,236 | 370,870 | 387,106 |
| Held-to-maturity investments | 159,430 | 523 | 1,486 | 161,439 |
| Other assets (Note: 23) | - | 958 | - | 958 |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Financial liabilities at amortised cost | - | 608,098 | 32,408 | 640,506 |
| Other liabilities (Note: 26) | - | 8,076 | - | 8,076 |

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 spread..

**Debt securities in issue**

Bonds issued are publicly traded and their fair values are based on quoted market prices. 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) | 2013 | 2012 |
|---|---|---|
| Cash and balances with central banks (Note: 14) | 44,235 | 18,301 |
| Loans and advances to credit institutions | 16,070 | 13,951 |
| Financial liabilities at amortised cost to credit institutions | (40,888) | (22,763) |
| **Cash and cash equivalents** | **19,417** | **9,489** |

**Change in operating assets**

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Net change in cash and balances with central banks (mandatory minimum reserves) | 320 | 1,744 |
| Net change in financial assets held for trading | (44,127) | 17,010 |
| Net change in financial assets designated at fair value through profit or loss | (176) | 641 |
| Net change in available-for-sale financial assets | (2,214) | 3,716 |
| Net change in loans and receivables | (25,559) | (32,749) |
| Net change in derivatives used for hedging | 3,935 | (1,679) |
| Net change in other assets | 182 | 45 |
| | **(67,639)** | **(11,272)** |

**Change in operating liabilities**

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Net change in financial liabilities held for trading | 56,603 | (31,722) |
| Net change in financial liabilities at amortised cost | 18,070 | 27,544 |
| Net change in derivatives used for hedging | 440 | 1,313 |
| Net change in other liabilities | 345 | 61 |
| | **75,458** | **(2,804)** |

**Non-cash items included in profit before tax**

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Allowances and provisions for credit losses (Note: 11) | 469 | 552 |
| Depreciation and amortisation | 451 | 502 |
| Amortisation of discounts and premiums in held-to-maturity investments | 170 | 651 |
| Impairment on investment securities (Note: 11) | 70 | 228 |
| Impairment on property and equipment (Note: 11) | 50 | 12 |
| Impairment of non-current assets held-for-sale ( Note: 11) | 7 | - |
| Impairment on other assets (Note: 11) | (1) | (288) |
| Provisions | (89) | 127 |
| Net change in fair value adjustments of the hedged items in portfolio hedge | (1,695) | 685 |
| Foreign exchange differences in held-to-maturity investments | (2,068) | 627 |
| Other | 100 | 4 |
| | **(2,536)** | **3,100** |

## 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 2013:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with Central banks (Note: 14) | 42,757 | - | - | - | 42,757 |
| Financial assets held for trading | | | | | |
| Financial derivatives | 5,614 | 5,419 | 1,337 | - | 12,370 |
| Other than financial derivatives | 171,780 | 16,874 | 5,016 | - | 193,670 |
| Financial assets designated at fair value through profit or loss | 1,248 | 3,502 | 3,793 | - | 8,543 |
| Available-for-sale financial assets | 8,573 | 39,390 | 20,991 | 627 | 69,581 |
| Loans and receivables | 135,365 | 138,999 | 110,259 | - | 384,623 |
| Fair value adjustments of the hedged items in portfolio hedge | 361 | 566 | - | - | 927 |
| Held-to-maturity investments | 7,468 | 51,714 | 86,285 | - | 145,467 |
| Derivatives used for hedging | 2,672 | 4,981 | 1,632 | - | 9,285 |
| Other assets (Note: 23) | 958 | - | - | - | 958 |
| **Total carrying value** | **376,796** | **261,445** | **229,313** | **627** | **868,181** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 7,278 | 5,947 | 1,612 | - | 14,837 |
| Other than financial derivatives | 175,447 | 1,567 | 622 | - | 177,636 |
| Financial liabilities at amortised cost | 156,299 | 227,761 | 252,602 | - | 636,662 |
| Fair value adjustments of the hedged items in portfolio hedge | 13 | 20 | (90) | - | (57) |
| Derivatives used for hedging | 2,833 | 4,499 | 1,760 | - | 9,092 |
| Other liabilities (Note: 26) | 8,076 | - | - | - | 8,076 |
| **Total carrying value** | **349,946** | **239,794** | **256,506** | - | **846,246** |

The following table sets out the financial assets and liabilities of the Bank by expected remaining maturity as at 31 December 2012:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with Central banks (Note: 14) | 18,031 | - | - | - | 18,031 |
| Financial assets held for trading | | | | | |
| Financial derivatives | 5,129 | 8,090 | 2,487 | - | 15,706 |
| Other than financial derivatives | 127,034 | 13,930 | 6,549 | - | 147,513 |
| Financial assets designated at fair value through profit or loss | 126 | 4,703 | 3,538 | - | 8,367 |
| Available-for-sale financial assets | 4,423 | 57,504 | 78,604 | 481 | 141,012 |
| Loans and receivables | 109,732 | 138,544 | 44,872 | - | 293,148 |
| Fair value adjustments of the hedged items in portfolio hedge | 306 | 724 | - | - | 1,030 |
| Held-to-maturity investments | 10,149 | 35,493 | 87,027 | - | 132,669 |
| Derivatives used for hedging | 3,434 | 7,725 | 3,293 | - | 14,452 |
| Other assets (Note: 23) | 1,107 | - | - | - | 1,107 |
| **Total carrying value** | **279,471** | **266,713** | **226,370** | **481** | **773,035** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 5,844 | 9,345 | 2,776 | - | 17,965 |
| Other than financial derivatives | 116,368 | 1,430 | 107 | - | 117,905 |
| Financial liabilities at amortised cost | 143,626 | 226,670 | 238,171 | - | 608,467 |
| Fair value adjustments of the hedged items in portfolio hedge | 196 | 721 | 824 | - | 1,741 |
| Derivatives used for hedging | 2,837 | 4,387 | 1,428 | - | 8,652 |
| Other liabilities (Note: 26) | 7,606 | - | - | - | 7,606 |
| **Total carrying value** | **276,477** | **242,553** | **243,306** | - | **762,336** |

## 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 uncertainty regarding the continuing court proceedings following the appeal by the counterparty against the ruling, the Bank will not recognise this amount in the statement of income until the final court ruling regarding the Bank's claim is known. 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 appeal court.

In 2013, the Bank successfully completed another case. Based on the final court decision, the Bank recognised a recovery (received already in 2010) relating to partially impaired loan in the amount of CZK 695 m as follows. An unimpaired part of the loan in the amount of CZK 319 m was redeemed and derecognised from the statement of the financial position. In the statement of income, penalty interest in the amount of CZK 178 m was recognised in Other net income, allowances in the amount of CZK 197 m were reversed in Impairment losses from loans and receivables and court expenses compensation income in the amount of CZK 1 m was recognised in General administrative expenses.

**Contingent liabilities and commitments**

The contingent liabilities and commitments at 31 December 2013 and 2012 are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Loan commitments - irrevocable (Note: 38.2) | 78,376 | 68,682 |
| Loan commitments - revocable | 39,321 | 47,401 |
| Financial guarantees (Note: 38.2) | 28,049 | 24,871 |
| Other commitments (Note: 38.2) | 2,417 | 1,493 |
| | **148,163** | **142,447** |
| Provisions for loan commitments and guarantees (Notes: 27, 38.2) | 324 | 325 |

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, 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) | 2013 | 2012 |
|---|---|---|
| Not later than 1 year | 1,715 | 1,557 |
| Later than 1 year and not later than 5 years | 1,746 | 1,945 |
| Later than 5 years | 176 | 260 |
| | **3,637** | **3,762** |

Future minimum sublease payments amounted to CZK 79 m as at 31 December 2013 (31 December 2012: CZK 29 m).

Operating lease commitments related to information technologies to KBC Global Services NV are included in ‘Not later than 1 year’ in the amount of CZK 949 m (2012: CZK 833 m). They represent expected half-year lease payments according to the committed notice period.

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) | 2013 | 2012 |
|---|---|---|
| Not later than 1 year | 43 | 24 |
| Later than 1 year and not later than 5 years | 127 | 10 |
| | **170** | **34** |

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.

## 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) | 2013 | 2012 |
|---|---|---|
| **Financial assets** | | |
| Cash and balances with central banks | 32,000 | 7,500 |
| Financial assets held for trading | 139,864 | 95,819 |
| | **171,864** | **103,319** |

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 as at 31 December 2013 was CZK 176,338 m, of which CZK 100,588 m has been either sold or repledged (31 December 2012: CZK 109,314 m and CZK 99,317 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) | 2013 | 2012 |
|---|---|---|
| **Financial liabilities** | | |
| Financial liabilities held for trading | 102,298 | 96,062 |
| Financial liabilities at amortised cost | 31,558 | 8,307 |
| | **133,856** | **104,369** |

Amounts of financial assets pledged as collateral in repo transactions are described in Financial assets at fair value through profit or loss (Note: 15) and Financial investments (Note: 16).

## 35. OFFSET FINANCIAL ASSETSS 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 2013:

| (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 |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 14,880 | - | 14,880 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 6,775 | - | 6,775 |
| **Total trading and hedging derivatives** | **21,655** | **-** | **21,655** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 171,864 | - | 171,864 |
| **Total repurchase agreements (Note: 34)** | **171,864** | **-** | **171,864** |
| Other financial assets set-off in the balance sheet | 263 | 263 | - |
| Other financial assets not set-off that are not subject to an enforceable master netting arrangement | 958 | - | 958 |
| **Total other financial assets (Note: 23)** | **1,221** | **263** | **958** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,656 | - | 18,656 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 5,273 | - | 5,273 |
| **Total trading and hedging derivatives** | **23,929** | **-** | **23,929** |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 13,099 | - | 13,099 |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 120,757 | - | 120,757 |
| **Total repurchase agreements (Note: 34)** | **133,856** | **-** | **133,856** |
| Other financial liabilities set-off in the balance sheet | 263 | 263 | - |
| Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement | 8,076 | - | 8,076 |
| **Total other financial liabilities (Note: 26)** | **8,339** | **263** | **8,076** |

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 2012:

| (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 |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,136 | - | 23,136 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 7,022 | - | 7,022 |
| **Total trading and hedging derivatives** | **30,158** | **-** | **30,158** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 103,319 | - | 103,319 |
| **Total repurchase agreements (Note: 34)** | **103,319** | **-** | **103,319** |
| Other financial assets set-off in the balance sheet | 401 | 401 | - |
| Other financial assets not set-off that are not subject to an enforceable master netting arrangement | 1,107 | - | 1,107 |
| **Total other financial assets (Note: 23)** | **1,508** | **401** | **1,107** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,057 | - | 23,057 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 3,561 | - | 3,561 |
| **Total trading and hedging derivatives** | **26,618** | **-** | **26,618** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 104,369 | - | 104,369 |
| **Total repurchase agreements (Note: 34)** | **104,369** | **-** | **104,369** |
| Other financial liabilities set-off in the balance sheet | 401 | 401 | - |
| Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement | 7,606 | - | 7,606 |
| **Total other financial liabilities (Note: 26)** | **8,007** | **401** | **7,606** |

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 2013:

| (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 | |
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 14,880 | 13,585 | 829 | - | 466 |
| **Total carrying value** | **14,880** | **13,585** | **829** | **-** | **466** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,656 | 13,585 | 4,919 | - | 152 |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 13,099 | - | - | 13,099 | - |
| **Total carrying value** | **31,755** | **13,585** | **4,919** | **13,099** | **152** |

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 2012:

| (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 | |
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,136 | 19,666 | 3,117 | - | 353 |
| **Total carrying value** | **23,136** | **19,666** | **3,117** | **-** | **353** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 23,057 | 19,666 | 2,852 | - | 539 |
| **Total carrying value** | **23,057** | **19,666** | **2,852** | **-** | **539** |

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 is executed with related parties in the normal course of business.

The outstanding balances of assets from related party transactions as at 31 December 2013 are as follows:

| (CZKm) | Financial assets held for trading | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets | Loans and receivables | Held- to-maturity investments | Derivatives used for hedging | Other assets |
|---|---|---|---|---|---|---|---|
| Directors / Senior management | - | - | - | - | - | - | - |
| KBC Bank NV | 3,012 | - | - | 3,078 | - | 3,901 | - |
| Entities under common control | | | | | | | |
| ČSOB SK | 439 | - | - | 146 | - | 116 | - |
| KBC Internationale Financieringsmij NV | 310 | - | - | 6,333 | - | - | - |
| Patria Direct, a. s. | 1 | - | - | - | - | - | - |
| Patria Finance, a. s. | 34 | - | - | - | - | - | - |
| Other | 73 | - | - | 204 | - | - | 28 |
| Subsidiaries | | | | | | | |
| BANIT | - | - | - | 63 | - | - | - |
| Centrum Radlická | - | - | - | 1,894 | - | - | - |
| ČSOB Factoring | - | - | - | 2,635 | - | - | - |
| ČSOB Leasing | 89 | - | - | 17,950 | - | - | - |
| ČSOB Property Fund | 68 | - | - | - | - | - | - |
| Hypoteční banka | 834 | 3,793 | 16,333 | 142,351 | 502 | - | - |
| Transformed fund | 321 | - | - | - | - | - | - |
| Associates | | | | | | | |
| ČSOB AM/IS | - | - | - | - | - | - | 146 |
| ČSOB Pojišťovna | - | - | - | - | - | 279 | - |
| Joint ventures | | | | | | | |
| ČMSS | - | - | - | 1,888 | - | - | - |

The outstanding balances of liabilities from related party transactions as at 31 December 2013 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Senior management | - | 74 | - | 49 |
| KBC Bank NV | 48,246 | 13,358 | 5,508 | 2 |
| Entities under common control | | | | |
| ČSOB SK | 13 | 49 | - | - |
| KBC Group (in 2013 merged with KBC Global Services NV) | - | 3 | - | 263 |
| Patria Direct, a. s. | 13 | 2,999 | - | - |
| Patria Finance, a. s. | - | 819 | - | - |
| Other | 13 | 196 | - | - |
| Subsidiaries | | | | |
| Centrum Radlická | - | 8 | - | - |
| ČSOB Advisory (formerly ČSOB IBS) | - | 2,053 | - | - |
| ČSOB Leasing | 2 | 52 | - | - |
| ČSOB PS | - | 2 | - | - |
| ČSOB Property Fund | 13 | 88 | - | - |
| Hypoteční banka | 5,120 | 12,411 | - | - |
| Associates | | | | |
| ČSOB AM/IS | - | 592 | - | - |
| ČSOB Pojišťovna | 74 | 2,173 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 22,142 | - | - |

The outstanding balances of assets from related party transactions as at 31 December 2012 are as follows:

| (CZKm) | Financial assets held for trading | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets | Loans and receivables | Held- to-maturity investments | Derivatives used for hedging | Other assets |
|---|---|---|---|---|---|---|---|
| Directors / Senior management | - | - | - | - | - | - | - |
| KBC Bank NV | 5,346 | - | - | 3,810 | - | 7,341 | - |
| Entities under common control | | | | | | | |
| ČSOB SK | 132 | - | - | 105 | - | 7 | - |
| KBC Internationale Financieringsmij NV | 543 | - | - | 6,343 | - | - | - |
| Patria Direct, a. s. | 75 | - | - | - | - | - | - |
| Patria Finance, a. s. | 56 | - | - | - | - | - | - |
| Other | 39 | - | - | 256 | - | - | - |
| Subsidiaries | | | | | | | |
| BANIT | - | - | - | 49 | - | - | - |
| Centrum Radlická | - | - | - | 1,984 | - | - | - |
| ČSOB Factoring | 50 | - | - | 2,499 | - | - | - |
| ČSOB Leasing | 450 | - | - | 14,758 | - | - | - |
| ČSOB PF Stabilita | 336 | - | - | - | - | - | - |
| ČSOB Property Fund | 62 | - | - | - | - | - | - |
| Hypoteční banka | 55 | 3,588 | 75,705 | 68,931 | 502 | - | - |
| Associates | | | | | | | |
| ČSOB Pojišťovna | - | - | - | - | - | 111 | 14 |
| Joint ventures | | | | | | | |
| ČMSS | - | - | - | 1,942 | - | - | - |

The outstanding balances of liabilities from related party transactions as at 31 December 2012 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Senior management | - | 181 | - | 43 |
| KBC Bank NV | 6,676 | 9,884 | 5,058 | 3 |
| Entities under common control | | | | |
| ČSOB SK | 147 | 13 | - | - |
| KBC Global Services NV | - | 463 | - | 139 |
| Patria Direct, a. s. | - | 1,374 | - | - |
| Patria Finance, a. s. | - | 378 | - | - |
| Other | 42 | 176 | - | - |
| Subsidiaries | | | | |
| Centrum Radlická | - | 9 | - | - |
| ČSOB Advisory (formerly ČSOB IBS) | - | 2,067 | - | - |
| ČSOB Leasing | - | 103 | - | - |
| ČSOB PF Stabilita | 110 | - | - | - |
| ČSOB Property Fund | 50 | 82 | - | - |
| Hypoteční banka | 1,600 | 18,639 | - | 2 |
| Associates | | | | |
| ČSOB AM/IS | - | 554 | - | - |
| ČSOB Pojišťovna | 32 | 2,502 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 24,222 | - | - |

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:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| (CZKm) | Interest income | Interest expense | Interest income | Interest expense |
| Directors / Senior management | - | - | - | 5 |
| KBC Bank NV | 851 | 1,301 | 562 | 922 |
| Entities under common control | | | | |
| ČSOB SK | 2 | - | 2 | - |
| KBC Internationale Financieringsmij NV | 118 | - | 165 | - |
| Kredyt Bank SA | - | - | 25 | - |
| Patria Direct, a. s | - | 4 | 1 | 6 |
| Patria Finance, a. s. | - | 2 | 1 | 1 |
| Other | 4 | - | 9 | 3 |
| Subsidiaries | | | | |
| Auxilium (in 2012 merged with ČSOB Advisory) | - | - | - | 8 |
| Centrum Radlická | 61 | - | 44 | - |
| ČSOB Factoring | 19 | - | 29 | - |
| ČSOB Advisory (formerly ČSOB IBS) | - | 10 | - | 18 |
| ČSOB Leasing | 350 | - | 410 | - |
| ČSOB Property Fund | 11 | 9 | 12 | 11 |
| Hypoteční banka | 3,368 | 662 | 4,122 | 806 |
| Associates | | | | |
| ČSOB AM/IS | - | 1 | - | 5 |
| ČSOB Pojišťovna | - | 19 | - | 25 |
| Joint ventures | | | | |
| ČMSS | 58 | 273 | 58 | 272 |

The balances of fee and commission income and expenses from related party transactions for the year ended 31 December are as follows:

| (CZKm) | 2013 Fee and commission income | 2013 Fee and commission expense | 2012 Fee and commission income | 2012 Fee and commission expense |
|---|---|---|---|---|
| KBC Bank NV | 57 | 7 | 64 | 1 |
| Entities under common control | | | | |
| KBC Global Services NV | - | 20 | - | 15 |
| KBC Group | - | 16 | - | - |
| KBC Securities NV | 11 | - | 8 | - |
| Patria Direct, a. s | 1 | - | 2 | - |
| Patria Finance, a. s. | - | - | 4 | - |
| Subsidiaries | | | | |
| BANIT | - | 114 | - | 100 |
| Hypoteční banka | 160 | - | 110 | - |
| Associates | | | | |
| ČSOB AM/IS | 292 | - | 262 | - |
| ČSOB Pojišťovna | 117 | - | 129 | - |
| Joint ventures | | | | |
| ČMSS | 5 | 10 | - | 6 |

Dividend income received from subsidiaries, associates and joint ventures in 2013 amounted to CZK 4,828 m (2012: CZK 5,250 m). Rental expenses paid to subsidiaries, associates and joint ventures in 2013 amounted to CZK 185 m (2012: CZK 185 m).

In accordance with the Group strategy, the Bank has been purchasing information and communication services from the related party KBC Global Services NV, since 2009. In 2013 KBC Global Services NV merged with KBC Group. KBC Group being the successor company.

Effective from 1 July 2009, the Bank concluded office space rental agreement and a service level agreement on a provision of administration services, such as human resources and accounting services, with KBC Global Services NV. In 2013, the Bank received income of CZK 75 m (2012: CZK 76 m) from the rental payments and related services, received CZK 41 m (2012: CZK 48 m) from the provision of administration services and paid expense of CZK 2,645 m (2012: CZK 2,674 m) for IT services, including rental expenses on information technologies.

In 2013, the Bank received income of CZK 102 m (2012: CZK 111 m) from ČSOB SK arising from providing services and support in the following areas such as: electronic banking, cards, payment processing, financial management and risk management.

The new debt instruments issued by the Greek government and EFSF originated from the voluntary exchange of Greek government bonds agreement held by the Group in the total carrying amount of CZK 1,115 m were sold at market price to KBC Credit Investments NV on 30 March 2012 (Note: 16).

In November 2012, ČSOB sold 24.76% of its ownership in ČSOB Pojišťovna to KBC Insurance NV and 4.21% of ČSOB AM/IS to KBC Participations Renta C, SA. As a result of the transactions with the companies under common control, ČSOB has realised net gain of CZK 1,271 m and CZK 75 m respectively, reported under Other net income in the statement of income for 2012 (Notes: 8, 18).

The outstanding contractual balances of the contingent assets and liabilities to the related parties at 31 December are as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| (CZKm) | Guarantees received | Guarantees given | Guarantees received | Guarantees given |
| KBC Bank NV | 7,269 | 213 | 7,493 | 198 |
| Entities under common control | | | | |
| Kereskedelmi és Hitelbank Rt. | - | 23 | - | - |
| ČSOB SK | - | 210 | - | 121 |
| Patria Direct, a. S | - | - | 75 | - |
| 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.

## 37. EVENTS AFTER THE END OF THE REPORTING PERIOD

There were no significant events after the end of 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 risk and market risk, the latter being 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 intended to be 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 II and, when implemented, Basel III, and the regulations of the CNB and other relevant regulators.

### 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, such as return on average equity (ROAE) and return on allocated capital (ROAC), and aligned consistently within the entire KBC Group, including ČSOB;
- 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 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 described above principles 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;

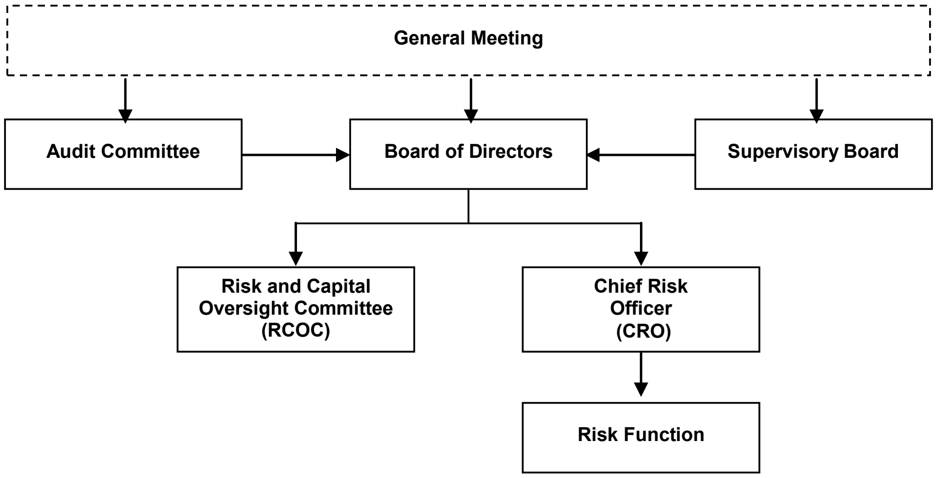
(ii) the RCOC is responsible for proposing the risk appetite and capital allocation to the Board of Directors, translating the approved risk appetite and capital allocation into numerical risk limits within its delegated authority, and regular monitoring of risk and capital against these limits,

(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***

The following chart sets forth an overview of the principal risk and capital management bodies and departments involved in the Bank's risk and capital management and control governance and responsibility structure.




*Supervisory Board*

The Supervisory Board is responsible for supervising the Board of Directors and ČSOB's business activities. The Supervisory Board regularly receives integrated risk and capital management reports prepared by the Integrated Risk Management Department (IRMD), as described below.

*Audit Committee*

The risk and capital management function of the Audit Committee is to supervise the risk appetite and capital allocation process, and ensure that appropriate risk controls have been put into place. In addition, the Audit Committee is responsible for ensuring that the ČSOB's risk and capital management policies are in compliance with legal and regulatory requirements. The Audit Committee regularly receives integrated risk management reports prepared by the IRMD.

*Board of Directors*

The Board of Directors is the sole integrated risk decision body responsible for establishing the risk appetite and capital allocation within ČSOB on an annual basis. This process involves

(i) the approval of the ČSOB's risk appetite statement;

(ii) the approval of the ČSOB's risk and capital strategy;

(iii) the approval of risk limits for ČSOB that are consistent with the ČSOB's risk appetite statement and risk and capital management strategy;

(iv) the allocation of regulatory and economic capital to the subsidiaries and business units within ČSOB with the aim of achieving an acceptable balance between return and risk and

(v) the approval of the ČSOB's risk and capital management governance structure and ensuring that it conforms with both internal guidelines and regulatory requirements.

On the basis of monthly integrated risk management reports prepared by the IRMD, the Board of Directors is also responsible for monitoring whether ČSOB's risk exposure is in conformity with ČSOB's risk 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 are to

(i) propose to the Board of Directors the risk appetite statement, risk and capital management strategy and risk limits for ČSOB;

(ii) review risk limits at regular intervals and propose changes to the same to the Board of Directors;

(iii) monitor risk exposure against risk limits;

(iv) take corrective actions, if needed, including bringing any material issues or concerns to the Board of Directors; and

(v) monitor capital adequacy and the usage of regulatory and economic capital.

As such, the RCOC assumes to a large extent, the limit setting and monitoring functions of the former ALCO. 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 for specific risk situations. The CRO is the chairman and the CFO is the vice-chairman of the RCOC.

*Chief Risk Officer (CRO)*

The CRO is responsible for ensuring that:

(i) proper risk management frameworks are in place and

(ii) ČSOB's risk and capital management strategy is properly implemented through risk management frameworks and policies.

The key responsibilities of the CRO are to:

(i) provide input for the determination of the risk appetite statement, risk and capital management strategy and risk limits for the ČSOB;

(ii) monitor whether risk management frameworks are implemented, maintained and enhanced to manage risk and capital within the risk appetite and capital allocation determined by the Board of Directors;

(iii) determine the design of the Risk Function, as described below,

(iv) determine the risk and capital management measurement techniques and tools, including models, to be used by ČSOB;

The CRO is a member of the Board of Directors, and regularly prepares reports to be provided by the Board of Directors to the Audit Committee and the Supervisory Board.

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 is a functional unit which underwent certain reorganisation as of November 2013. It consisted of Integrated Risk Management Department (IRMD), Risk Specific Management Department (RSMD), Risk Shared Services Department (RSSD) and Validation Department, each headed by a manager reporting directly to CRO.

The departments had following roles:

*Integrated Risk Management Department (IRMD)*

The IRMD was responsible for managing the process of measuring and monitoring risk on an integrated basis within the ČSOB Group. In particular, the IRMD performed 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). The IRMD also regularly provided reports to the supervisory section of the CNB.

*Risk Specific Management Department (RSMD)*

The RSMD was responsible for managing credit risk, liquidity risk, operational risk and market risk. In particular, the RSMD was 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.

Within the RSMD, the information security officer was responsible for determining the risk frameworks for informational risk, including cyber risk, and the monitoring of these risks.

*Risk Shared Services Department (RSSD)*

The RSSD was responsible for supporting all the other departments forming the Risk Function in data management and reporting. In particular, the RSSD:

(i) maintains all ICT applications needed for the performance of risk and capital management;

(ii) designs the technical ICT architecture in cooperation with the ICT; and

(iii) performs activities aimed at ensuring the correct flow of data needed for proper risk and capital monitoring.

The RSSD was responsible for risk data governance and also forms the link between the requirements of the IRMD and RSMD departments and the ICT.

*Validation Department*

The Validation Department was responsible for the validation of all risk measurement tools and methodologies used within ČSOB, which are used to calculate the value of credit, ALM, market and other instruments for risk and capital management purposes, including the risk measurement models developed at the KBC Group level.

Since November 2013, there one division called the Group Risk Management division has been created and is headed by one manager reporting directly to the CRO.

The division consists of the Credit Risk management, the Market and Liquidity risk management department and the Non-financial risk management department.

This group of departments is responsible for managing credit risk, liquidity risk, market risk, operational risk, business risk and strategic risk. In particular, they are:

(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) responsible for information security frameworks for informational risk, including cyber risk, and the monitoring of these risks;

(iv) responsible for integrated risk reporting (see Risk Monitoring and Reporting below);

(v) responsible for the management of economic capital.

The division further consists of the following units:

Integrated Risk Management Team, which is responsible for managing the process of measuring and monitoring risk on an integrated basis within the ČSOB Group. In particular, the team oversees the ICAAP process (see ICAAP Process below). The Team also regularly provides reports to the supervisory section of the CNB.

The data management department is responsible for supporting all the other departments forming the Risk Function in data management. In particular it:

(i) maintains all ICT applications needed for the performance of risk and capital management;

(ii) designs the technical ICT architecture in cooperation with the ICT; and

(iii) performs activities aimed at ensuring the correct flow of data needed for proper risk and capital monitoring.

*Group Validation Department*

The Validation Department is responsible for the validation of all risk measurement tools and methodologies used within the ČSOB Group, which are used to calculate the value of credit, ALM, market and other instruments for risk and capital management purposes, including the risk measurement models developed at the KBC Group level.

*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:

  (i) where the decision impacts 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 decision impacts 2% of the ČSOB Group's estimated underlying profit (calculated by Controlling Department for the purposes of management) for the current year.

  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 underlying profit for the current year.

- to the CRO, the authority to decide on matters falling below the above-mentioned thresholds. The CRO may sub-delegate this authority further to one of the departments forming the Risk Function.

Additionally, the CRO may submit to the Board of Directors, the Supervisory Board 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 the 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 annually audits risk and 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)*

NAPPs 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 analyzed 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)***

In order to facilitate the performance of day-to-day risk and capital management in close cooperation with the business, the business and the Risk Function conduct BRMs. The BRMs take place on a regular (usually monthly or quarterly) basis, and typically discuss issues concerning the monitoring of risk and implementation of risk frameworks. The BRMs are not decision bodies, but they are useful platform where business proposals can be discussed from a risk point of view.

***Internal Capital Adequacy Assessment Process (ICAAP)***

The New 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).

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 senior 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 National Bank of Belgium).

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.

Information about the ICAAP, including data on the state and anticipated development of internal capital adequacy, is also regularly presented to the senior management, including the RCOC.

When setting and assessing - on an ongoing basis - its internal capital needs, and planning and maintaining its internal capital resources, ČSOB uses a completely economic-value-based 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 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 them when planning and securing internal capital resources. The ICAAP strategic planning horizon is three years.

The amount of capital need is determined using the economic capital method and addresses the following material risks to which the Group is or may be exposed:

- Credit risk, including concentration risk
- Market risk in the trading book
- Operational risk
- ALM risk
- Business risk

A relevant amount of economic capital is allocated directly to these types of risk. Other risks, such as liquidity risk, strategic risk and reputation risk, are covered, under ICAAP processes, by qualitative measures in risk management, organisation of processes, control mechanisms, etc.

The amount of capital need 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 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 senior 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 senior 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 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.

Until September 2012, the Bank had been using the IRB Foundation approach for the capital calculations of its non-retail exposures and IRB Advance approach for its retail exposures. As a result, credit risk had been measured, monitored and managed based on principles of this approach.

For the non-retail exposure (Corporate, non-retail SME, Banks, Non-Banking financial institutions), counterparty risk (i.e. default risk) was managed based on statistical default prediction models that establish a rating (PD / Probability of Default) while LGD (Loss Given Default) and EAD (Exposure at Default) were based on regulatory values for capital calculation purposes and on expert estimates combined with historical data for credit decision purposes.

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).

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 principles of this approach.

The counterparty risk (i.e. default risk) is still managed based on statistical default prediction models that establish not only rating (PD / Probability of Default), but also LGD (Loss Given Default) and EAD (Exposure at Default). Risk factors are still determined in Retail based on risk-homogenous sets of exposure (so called pools).

The model results are used for 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 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 the ČSOB is more than 90 days past the due date.

**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 or 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 11 and 12 represent customers, who have been overdue for 90 days or more, 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 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 irrespective of whether or not they are overdue (after six months of performance, the restructured loan may be requalified); and

PD 1 to PD 9 represent the remaining exposures.

PD ratings are used not only for the measurement, monitoring and management of credit risk, but also to determine, amongst 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:

| ČSOB risk categories for Non-retail exposure | | | | | ČSOB and CNB risk categories | CNB risk categories |
|---|---|---|---|---|---|---|
| PD Scale | PD Rating | S&P Rating | Performance | Impairment | | |
| Normal | 1-7 | AAA - B | Performing customers | Unimpaired | Non-defaulted | Standard |
| Asset Quality review (AQR) | 8-9 | B- - C | Performing customers | Collectively impaired | Non-defaulted | Watched |
| Uncertain – performing | 10 | D | Performing customers | Individually impaired | Defaulted | Substandard |
| Uncertain – non-performing | 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 RSMD 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) or one of its sub-committees consisting of business line employees and employees in the Credit Department. All members of the CSC and its sub-committees must agree in order to approve a credit.

Within the delegation framework set by the RCOC, 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 eye principle”, i.e. at least 2 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 (PD 1 – 7 for non-retail SMEs) are reviewed by the distribution with support of monitoring applications. Credit exposures with a rating between PD 9 – 12 (PD 8 – 12 for non-retail SMEs) 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 review at least once a year in accordance with the same application process as for 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 8 in the case of non-retail SME customers, or a PD rating of 9, in the case of corporate customers. For corporate customers, a PD rating of 8 triggers a requirement for a written advice from the Bad Debt Department.

**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:

| ČSOB risk categories for Retail exposure | | | | ČSOB and CNB risk categories | CNB risk categories |
|---|---|---|---|---|---|
| PD Scale | Days overdue | Performance | Impairment | | |
| Normal | 0 - 30 | Performing | Unimpaired | Non-defaulted | Standard |
| Asset Quality review (AQR) | 31 - 90 | Performing | Collectively impaired | 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 loans fall initially within the non-performing category irrespective of whether or not they are overdue. After six months of performance under the restructured loan, it may be requalified as performing.

*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 in the vast majority of cases fully automated based on scorecards. 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 by the relevant Credit Departments and the RSMD and is based on aggregated data, does not involve individual reviews and looks at the development of defaults within different sub-portfolios. Typically, different product portfolios are reviewed monthly based on so-called vintages (in terms of origination date and number of months on the Bank's books) and the development of Credit Cost Ratios in the different sub-portfolios. Additionally, the development of the retail portfolio is monitored 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 starts when any payment is 90 days overdue, and is focused on legal proceedings and the recovery of collateral. All collection units within the Bank are managed by the relevant Credit Departments and 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 the 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 (rating AA and better), 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 2013. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Settlement accounts and Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with central banks (Note: 14) | - | 42,757 | - | - | 42,757 |
| Financial assets held for trading | - | 515 | 205,525 | - | 206,040 |
| Financial assets designated at fair value through profit or loss | 192 | 8,351 | - | - | 8,543 |
| Available-for-sale financial assets | 2,748 | 66,833 | - | - | 69,581 |
| Loans and receivables | 204,384 | 177,396 | - | 2,843 | 384,623 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 927 | - | - | 927 |
| Held-to-maturity investments | 192 | 145,275 | - | - | 145,467 |
| Derivatives used for hedging | - | 9,285 | - | - | 9,285 |
| Other assets (Note: 23) | - | - | - | 958 | 958 |
| Total | 207,516 | 451,339 | 205,525 | 3,801 | 868,181 |
| Contingent liabilities (Note: 33) | 30,142 | - | - | - | 30,142 |
| Commitments – irrevocable (Note: 33) | 76,229 | 2,147 | - | - | 78,376 |
| Total | 106,371 | 2,147 | - | - | 108,518 |
| **Total credit risk exposure** | **313,887** | **453,486** | **205,525** | **3,801** | **976,699** |

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2012. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Settlement accounts and Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with central banks (Note: 14) | - | 18,031 | - | - | 18,031 |
| Financial assets held for trading | - | 1,677 | 161,542 | - | 163,219 |
| Financial assets designated at fair value through profit or loss | 176 | 8,191 | - | - | 8,367 |
| Available-for-sale financial assets | 1,267 | 139,745 | - | - | 141,012 |
| Loans and receivables | 187,537 | 99,926 | - | 5,685 | 293,148 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 1,030 | - | - | 1,030 |
| Held-to-maturity investments | 601 | 132,068 | - | - | 132,669 |
| Derivatives used for hedging | - | 14,452 | - | - | 14,452 |
| Other assets (Note: 23) | - | - | - | 1,107 | 1,107 |
| Total | 189,581 | 415,120 | 161,542 | 6,792 | 773,035 |
| Contingent liabilities (Note: 33) | 26,039 | - | - | - | 26,039 |
| Commitments – irrevocable (Note: 33) | 68,591 | 91 | - | - | 68,682 |
| Total | 94,630 | 91 | - | - | 94,721 |
| **Total credit risk exposure** | **284,211** | **415,211** | **161,542** | **6,792** | **867,756** |

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) | 2013 Gross maximum exposure | 2013 Financial effect of collateral | 2013 Net maximum exposure | 2012 Gross maximum exposure | 2012 Financial effect of collateral | 2012 Net maximum exposure |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and balances with central banks (Note: 14) | 42,757 | 32,000 | 10,757 | 18,031 | 7,500 | 10,531 |
| Financial assets held for trading | 206,040 | 140,036 | 66,004 | 163,219 | 95,889 | 67,330 |
| Financial assets designated at fair value through profit or loss | 8,543 | - | 8,543 | 8,367 | - | 8,367 |
| Available-for-sale financial assets | 69,581 | - | 69,581 | 141,012 | - | 141,012 |
| Loans and receivables | 384,623 | 93,140 | 291,483 | 293,148 | 87,938 | 205,210 |
| Fair value adjustments of the hedged items in portfolio hedge | 927 | - | 927 | 1,030 | - | 1,030 |
| Held-to-maturity investments | 145,467 | - | 145,467 | 132,669 | - | 132,669 |
| Derivatives used for hedging | 9,285 | 657 | 8,628 | 14,452 | 3,048 | 11,404 |
| Other assets (Note: 23) | 958 | - | 958 | 1,107 | - | 1,107 |
| Total | 868,181 | 265,833 | 602,348 | 773,035 | 194,375 | 578,660 |
| Contingent liabilities and commitments – irrevocable (Note: 33) | 108,518 | 20,623 | 87,895 | 94,721 | 19,957 | 74,764 |
| **Total credit risk exposure** | **976,699** | **286,456** | **690,243** | **867,756** | **214,332** | **653,424** |

The portfolios are further structured as follows:

The credit portfolio is structured according to the type of the business, the Bank enters into:

| 2013 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Corporate | 121,565 | 27,085 | 42,448 | **191,098** | (2,175) | (54) | **188,869** |
| SME | 73,731 | 3,030 | 23,775 | **100,536** | (3,463) | (53) | **97,020** |
| Retail | 19,141 | 12 | 8,974 | **28,127** | (1,285) | (5) | **26,837** |
| Other | 33 | 339 | 1,032 | **1,404** | (31) | (212) | **1,161** |
| | **214,470** | **30,466** | **76,229** | **321,165** | **(6,954)** | **(324)** | **313,887** |

| 2012 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Corporate | 106,585 | 23,568 | 37,248 | **167,401** | (2,389) | (65) | **164,947** |
| SME | 70,763 | 2,559 | 20,935 | **94,257** | (3,508) | (44) | **90,705** |
| Retail | 19,130 | 8 | 10,076 | **29,214** | (1,301) | (6) | **27,907** |
| Other | 538 | 229 | 332 | **1,099** | (237) | (210) | **652** |
| **Total credits** | **197,016** | **26,364** | **68,591** | **291,971** | **(7,435)** | **(325)** | **284,211** |

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 | 2013 Granted exposure (CZKm) | 2013 Percentage of total exposure | 2012 Granted exposure (CZKm) | 2012 Percentage of total exposure |
|---|---|---|---|---|
| Services | 46,903 | 14.6 | 47,931 | 16.4 |
| Distribution | 40,208 | 12.5 | 36,549 | 12.5 |
| Automotive | 25,837 | 8.0 | 19,093 | 6.5 |
| Private persons | 25,532 | 7.9 | 26,776 | 9.2 |
| Building and Construction | 25,044 | 7.8 | 25,399 | 8.7 |
| Commercial Real Estate | 24,173 | 7.5 | 23,374 | 8.0 |
| Machinery and Heavy Equipment | 17,621 | 5.5 | 12,820 | 4.4 |
| Authorities | 16,094 | 5.0 | 14,723 | 5.0 |
| Electricity | 14,616 | 4.6 | 12,889 | 4.4 |
| Oil, Gas and other Fuels | 14,534 | 4.5 | 8,572 | 2.9 |
| Finance and Insurance | 13,842 | 4.3 | 13,956 | 4.8 |
| Metals | 10,212 | 3.2 | 10,356 | 3.6 |
| Telecommunications | 8,251 | 2.6 | 4,136 | 1.4 |
| Electrotechnics | 5,851 | 1.8 | 5,830 | 2.0 |
| Chemicals | 3,777 | 1.2 | 3,535 | 1.2 |
| Food producers | 3,685 | 1.1 | 3,651 | 1.3 |
| Other sectors | 24,985 | 7.9 | 22,381 | 7.7 |
| **Total** | **321,165** | **100.0** | **291,971** | **100.0** |

The investment portfolio is structured according to type of the instrument:

| 2013 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 219,833 | - | - | - | **219,833** |
| Equity securities | 706 | - | - | (79) | **627** |
| Loans and receivables within investment portfolio | 178,322 | - | 2,147 | - | **180,469** |
| Derivatives used for hedging | 9,285 | - | - | - | **9,285** |
| Derivatives held for trading | 515 | - | - | - | **515** |
| Cash and balances with central banks | 42,757 | - | - | - | **42,757** |
| **Total investment** | **451,418** | **-** | **2,147** | **(79)** | **453,486** |

| 2012 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 279,523 | - | - | - | **279,523** |
| Equity securities | 597 | - | - | (116) | **481** |
| Loans and receivables within investment portfolio | 100,956 | - | 91 | - | **101,047** |
| Derivatives used for hedging | 14,452 | - | - | - | **14,452** |
| Derivatives held for trading | 1,677 | - | - | - | **1,677** |
| Cash and balances with central banks | 18,031 | - | - | - | **18,031** |
| **Total investment** | **415,236** | **-** | **91** | **(116)** | **415,211** |

The investment portfolio is monitored from counterparty sector point of view:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| Sector | Granted exposure (CZKm) | Percentage of total exposure | Granted exposure (CZKm) | Percentage of total exposure |
| Central government | 214,403 | 47.3 | 188,498 | 45.4 |
| Credit institutions | 212,191 | 46.8 | 205,744 | 49.6 |
| Corporate | 26,631 | 5.9 | 20,731 | 5.0 |
| Non-credit institutions | 261 | - | 238 | - |
| **Total investment** | **453,486** | **100.0** | **415,211** | **100.0** |

The trading portfolio is structured according to type of the instrument:

| 2013<br>(CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 34,239 | - | - | 34,239 |
| Loans and advances | 159,431 | - | - | 159,431 |
| Derivatives held for trading | 11,855 | - | - | 11,855 |
| **Total trading portfolio** | **205,525** | **-** | **-** | **205,525** |

| 2012<br>(CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 35,728 | - | - | 35,728 |
| Loans and advances | 111,785 | - | - | 111,785 |
| Derivatives held for trading | 14,029 | - | - | 14,029 |
| **Total trading portfolio** | **161,542** | **-** | **-** | **161,542** |

The trading portfolio is monitored from counterparty sector point of view:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| Sector | Granted exposure (CZKm) | Percentage of total exposure | Granted exposure (CZKm) | Percentage of total exposure |
| Central government | 177,880 | 86.5 | 129,806 | 80.4 |
| Credit institutions | 23,181 | 11.3 | 25,759 | 15.9 |
| Corporate | 4,455 | 2.2 | 5,956 | 3.7 |
| Non-credit institutions | 9 | - | 21 | - |
| **Total trading portfolio** | **205,525** | **100.0** | **161,542** | **100.0** |

**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:

| (CZKm) | 2013 Total risk | 2013 of which Central government | 2012 Total risk | 2012 of which Central government |
|---|---|---|---|---|
| Czech Republic | 895,672 | 383,254 | 789,786 | 308,198 |
| Slovak Republic | 6,034 | 1,389 | 4,662 | 1,035 |
| Greece | 2 | - | - | - |
| Italy | 9,789 | - | 6,720 | - |
| Spain | 576 | - | 176 | - |
| Belgium | 12,440 | 2,594 | 19,581 | 2,449 |
| Hungary | 65 | - | 14 | - |
| Other Europe | 49,034 | 6,059 | 43,642 | 6,913 |
| Other | 3,087 | - | 3,175 | - |
| **Total** | **976,699** | **393,296** | **867,756** | **318,595** |

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 | 2013 Granted exposure (CZK m) | 2013 % of total credit portfolio | 2012 Granted exposure (CZK m) | 2012 % of total credit portfolio |
|---|---|---|---|---|
| 1 largest client | 7,225 | 2.2 | 6,479 | 2.2 |
| 10 largest clients | 43,616 | 13.6 | 32,489 | 11.1 |
| 25 largest clients | 74,250 | 23.1 | 55,937 | 19.2 |

The largest exposure to a single client as at 31 December 2013 was CZK 225,124 m in the investment portfolio (31 December 2012: CZK 179,032 m) to the Czech Government and CZK 158,130 m (31 December 2012: CZK 129,166 m) to the Czech Government in the trading portfolio.

**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, inventory and trade receivables;
- For retail lending, pledges over residential properties are used for mortgage financing.

The Bank continuously monitors the market value of all collaterals, 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.

The Bank also makes use of master netting agreements with counterparties.

**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, whereas 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 loan with outstanding above 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 is not yet recognised objective evidence of impairment and they reflect impairment that is likely to be present in the group of assets although. Collective allowances are assessed based on statistical estimates and evaluated at each reporting period.

Impairment losses 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); and

(iv) the expected receipts and recoveries once impaired;

The local management is responsible for deciding the length of emergence period. In both 2013 and 2012, the Bank used a uniform emergence period of four months, which was confirmed by backtesting.

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 at 31 December 2013 and 2012 per individual portfolios:

| **Credit portfolio** | 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Unimpaired | Impaired assets | | | | Total |
| | assets | Collectively | Individually | | | |
| (CZKm) | Normal | AQR | Uncertain (Performing) | Uncertain (Non-performing) | Irrecoverable | |
| Corporate | 113,119 | 3,841 | 2,843 | 4 | 1,758 | 121,565 |
| SME | 67,157 | 1,489 | 1,220 | 495 | 3,370 | 73,731 |
| Retail | 17,444 | 255 | 206 | 243 | 993 | 19,141 |
| Other | 2 | - | - | - | 31 | 33 |
| **Total** | **197,722** | **5,585** | **4,269** | **742** | **6,152** | **214,470** |

| Credit portfolio | 2012 | | | | | |
| --- | --- | --- | --- | --- | --- | --- |
| | Unimpaired assets | Impaired assets | | | | Total |
| | | Collectively | Individually | | | |
| (CZKm) | Normal | AQR | Uncertain (Performing) | Uncertain (Non-performing) | Irrecoverable | |
| Corporate | 97,745 | 3,822 | 3,033 | 254 | 1,731 | 106,585 |
| SME | 64,009 | 1,795 | 1,104 | 443 | 3,412 | 70,763 |
| Retail | 17,365 | 248 | 183 | 248 | 1,086 | 19,130 |
| Other | - | 6 | - | - | 532 | 538 |
| **Total** | **179,119** | **5,871** | **4,320** | **945** | **6,761** | **197,016** |

| Investment portfolio | 2013 | | |
| --- | --- | --- | --- |
| | Unimpaired assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 219,833 | - | 219,833 |
| Equity securities | 626 | 1 | 627 |
| Loans and receivables within investment portfolio | 178,322 | - | 178,322 |
| Derivatives used for hedging | 9,285 | - | 9,285 |
| Derivative contracts held for trading | 515 | - | 515 |
| Cash and balances with central banks | 42,757 | - | 42,757 |
| **Total** | **451,338** | **1** | **451,339** |

| Investment portfolio | 2012 | | |
| --- | --- | --- | --- |
| | Unimpaired Assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 279,523 | - | 279,523 |
| Equity securities | 476 | 5 | 481 |
| Loans and receivables within investment portfolio | 100,956 | - | 100,956 |
| Derivatives used for hedging | 14,452 | - | 14,452 |
| Derivative contracts held for trading | 1,677 | - | 1,677 |
| Cash and balances with central banks | 18,031 | - | 18,031 |
| **Total** | **415,115** | **5** | **415,120** |

| Trading portfolio | 2013 | | |
| --- | --- | --- | --- |
| | Unimpaired Assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 34,239 | - | 34,239 |
| Loans and advances | 159,431 | - | 159,431 |
| Derivative contracts held for trading | 11,855 | - | 11,855 |
| **Total** | **205,525** | **-** | **205,525** |

**Trading portfolio**

| (CZKm) | 2012 Unimpaired Assets Normal | 2012 Individually impaired assets Irrecoverable | 2012 Total |
|---|---|---|---|
| Debt securities | 35,728 | - | 35,728 |
| Loans and advances | 111,785 | - | 111,785 |
| Derivative contracts held for trading | 14,029 | - | 14,029 |
| **Total** | **161,542** | **-** | **161,542** |

The table below shows an ageing analysis of gross past due but not impaired financial assets in the Credit portfolio:

| (CZKm) | 2013 Less than 30 days | 2012 Less than 30 days |
|---|---|---|
| SME | 265 | 212 |
| Retail | 626 | 434 |
| **Total** | **891** | **646** |

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) | 2013 Gross amount | 2013 Impairment | 2012 Gross amount | 2012 Impairment |
|---|---|---|---|---|
| Credit portfolio | | | | |
| Corporate | 4,605 | (2,111) | 5,018 | (2,308) |
| SME | 5,085 | (3,333) | 4,959 | (3,401) |
| Retail | 1,442 | (1,161) | 1,517 | (1,209) |
| Other | 31 | (31) | 532 | (228) |
| **Total** | **11,163** | **(6,636)** | **12,026** | **(7,146)** |

Individually impaired financial assets included in the investment portfolio in the carrying amounts are as follows:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Debt securities | - | - |
| Equity securities | 1 | 5 |
| **Total** | **1** | **5** |

### 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 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).

**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 senior management of ČSOB.

The NSFR during the year 2013 and 2012 was as follows:

| (%) | 2013 | 2012 |
|---|---|---|
| 31 March | 129.8 | 125.3 |
| 30 June | 132.2 | 123.3 |
| 30 September | 136.4 | 121.2 |
| 31 December | 139.4 | 125.9 |

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 2013:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | - | 7,278 | 5,988 | 1,771 | 15,037 |
| Other than financial derivatives | - | 175,447 | 1,589 | 657 | 177,693 |
| Financial liabilities at amortised cost | 522,346 | 83,272 | 22,103 | 12,767 | 640,488 |
| Fair value adjustments of the hedged items in portfolio hedge | (57) | - | - | - | (57) |
| Derivatives used for hedging | - | 2,833 | 4,535 | 1,971 | 9,339 |
| Other liabilities (Note: 26) | - | 8,076 | - | - | 8,076 |
| **Total carrying value** | **522,289** | **276,906** | **34,215** | **17,166** | **850,576** |

The following table sets out the financial liabilities of the Bank by remaining contractual maturity as at 31 December 2012:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | - | 5,844 | 9,454 | 3,005 | 18,303 |
| Other than financial derivatives | - | 116,368 | 1,454 | 112 | 117,934 |
| Financial liabilities at amortised cost | 490,961 | 77,083 | 31,302 | 12,631 | 611,977 |
| Fair value adjustments of the hedged items in portfolio hedge | 1,741 | - | - | - | 1,741 |
| Derivatives used for hedging | - | 2,836 | 4,434 | 1,578 | 8,848 |
| Other liabilities (Note: 26) | - | 7,606 | - | - | 7,606 |
| **Total carrying value** | **492,702** | **209,737** | **46,644** | **17,326** | **766,409** |

The maturity of contingent liabilities and commitments of CZK 148,163 m (2012: CZK 142,447 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. For example, undrawn loan commitments are not expected to be drawn down immediately (Note: 32).

## *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 of EUR 6 m is set for interest rate options, commodity derivatives and structured bonds; the position in these products, however is not material.

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 real profit or loss made by trading book.

The Bank received a regulatory approval to use an internal VaR model for the calculation of capital requirements for interest rate and foreign exchange risks in June 2007.

ČSOB calculate a Stress VaR to fulfil CRD 3 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 2013 and 2012:

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2013 | 119 | 10 | (6) | 123 |
| Average during the period | 134 | 6 | (5) | 135 |
| Highest | 210 | 27 | (22) | 215 |
| Lowest | 56 | 1 | - | 57 |

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2012 | 58 | 4 | (4) | 58 |
| Average during the period | 110 | 8 | (8) | 110 |
| Highest | 173 | 26 | (23) | 176 |
| Lowest | 57 | 1 | (1) | 57 |

**Market risk – Non-trading**

*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 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 2013 due to revaluation of assets and liabilities that are measured at fair value on recurring basis:

| | | Sensitivity of the statement of income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (1.2) | (2.2) | 7.9 | (20.7) | (16.2) |
| EUR | + 10 | 1.6 | 1.1 | 2.5 | 1.6 | 6.8 |
| USD | + 10 | 0.0 | 0.0 | (0.3) | (0.1) | (0.4) |
| CZK | - 10 | 1.2 | 2.2 | (7.9) | 20.7 | 16.2 |
| EUR | - 10 | (1.6) | (1.1) | (2.5) | (1.6) | (6.8) |
| USD | - 10 | 0.0 | 0.0 | 0.3 | 0.1 | 0.4 |

| | | Sensitivity of other comprehensive income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (1.4) | 10.2 | (135.5) | (138.0) | (264.7) |
| EUR | + 10 | 3.4 | 0.2 | 25.6 | 98.6 | 127.8 |
| USD | + 10 | 0.0 | (0.3) | (3.7) | (3.4) | (7.4) |
| CZK | - 10 | 1.4 | (10.2) | 135.5 | 138.0 | 264.7 |
| EUR | - 10 | (3.4) | (0.2) | (25.6) | (98.6) | (127.8) |
| USD | - 10 | 0.0 | 0.3 | 3.7 | 3.4 | 7.4 |

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) as at 31 December 2012 due to revaluation of assets and liabilities that are measured at fair value on recurring basis:

| | | Sensitivity of the statement of income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (10.1) | 1.7 | 71.8 | (57.1) | 6.3 |
| EUR | + 10 | 1.2 | (0.1) | 3.9 | 2.8 | 7.8 |
| USD | + 10 | 0.3 | 0.0 | (2.9) | 0.0 | (2.6) |
| CZK | - 10 | 10.1 | (1.7) | (71.8) | 57.1 | (6.3) |
| EUR | - 10 | (1.2) | 0.1 | (3.9) | (2.8) | (7.8) |
| USD | - 10 | (0.3) | 0.0 | 2.9 | 0.0 | 2.6 |

| | | Sensitivity of other comprehensive income | | | | |
|---|---|---|---|---|---|---|
| (CZKm) | Change in basis points | Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
| CZK | + 10 | (11.0) | (3.9) | (240.9) | (429.8) | (685.6) |
| EUR | + 10 | 0.4 | (0.4) | 1.9 | 87.3 | 89.2 |
| USD | + 10 | 0.0 | 0.0 | (4.3) | (5.9) | (10.2) |
| CZK | - 10 | 11.0 | 3.9 | 240.9 | 429.8 | 685.6 |
| EUR | - 10 | (0.4) | 0.4 | (1.9) | (87.3) | (89.2) |
| USD | - 10 | 0.0 | 0.0 | 4.3 | 5.9 | 10.2 |

*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 2013 and 2012:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| (CZKm) | Net position in foreign currency | 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 | 18 | 1 | (1) | 40 | 2 | (2) |

Sensitivity of the statement of income to currencies other than EUR is not significant.

*Equity price risk*

The Bank has no significant equity risk in investment portfolio.

*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.

## *38.5 Operational risk*

The Bank defines operational risk in line with Basel II 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 decision of accountable manager, i.e. acceptance of risk or its mitigation by implementing appropriate control measures. Risk events that cannot be prevented may be also mitigated by business continuity arrangements and/or transfers of risk to third parties (e.g. by insurance) to the extent possible.

**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.

*Operational Risk Management Department (ORMD)*

The ORMD is responsible for reporting in the operational risk management area, including coordination, the implementation of methodology, the assurance of independent control, advisory to business units and training. ORMD 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 ORMD 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 the key residual operational risks faced in order to reach a consensus on the adequate risk response (risk acceptance or mitigation).

*Global Risk Scan*

The Global Risk Scan is a structured risk self assessment organised as an interview based on uniform questionnaires. The goal of the exercise is to identify the key risks that are relevant for the senior management. Such risks are likely to differ from the risks identified during the detailed risk scan involving business experts closer to the working floor. Results of Global Risk Scan are used also as underpin of the Economic Capital for Operational and Business risk.

*Group Key Controls and Zero Tolerances*

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 relates to the level of capital a financial institution needs to implement its business plans, taking into consideration the risks that threaten the realisation of such plans.

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.

### Managing solvency

ČSOB reports its solvency calculating it on the basis of IFRS figures and the relevant guidelines issued by the Czech regulator - the Czech National Bank, mainly its Decree No. 123/2007 Coll. stipulating the prudential rules for banks, credit unions and investment firms. Regulatory minimum solvency targets were met in 2013, not only at year-end, but also throughout the entire year.

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 II, Pillar 2 requirements, the Bank has an Internal Capital Adequacy Assessment Process (ICAAP) in place. In addition to the regulatory capital requirements, this process also uses an economic capital model to measure capital requirements based on aggregate group-wide risks, and to compare these requirements with the capital available to cover risks. The ICAAP examines both the current and future capital situation. To assess the latter situation, a three-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 and a recession scenario.

The Basel III agreement and corresponding European CRD IV Directive and Regulation will introduce new, more stringent capital requirements for financial institutions. According to these requirements, the legal minimum tier-1 ratio, which stood at 4% under Basel II, will be increased to 4.5% in 2014, and gradually increase to 6% (with a common equity ratio of 4.5%). On top of this, a so-called 'capital conservation buffer' (2.5% Common Equity Tier 1), a 'countercyclical buffer' (of between 0% and 2.5% Common Equity Tier 1, to be determined by the national regulatory authority) and an extra charge for systemic risks banks will be applied. The Bank analysed the impact of the Basel III and incorporated major changes / ratios into 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 securities.

No significant changes have been made to the objectives, policies and processes from the previous years.

The following table shows the capital and CAD ratio calculated under Basel II for ČSOB:

| (CZKm) | 2013 | 2012 |
|---|---|---|
| Tier 1 capital | 48,241 | 37,832 |
| Tier 2 capital | 706 | 7,983 |
| Deductible items of Tier 1 and Tier 2 | (23) | (260) |
| **Total capital** | **48,924** | **45,555** |
| Capital requirements | 25,547 | 25,240 |
| **Risk weighted assets** | **319,339** | **315,498** |
| Capital adequacy ratio | 15.32% | 14.44% |

NOTES

# Report of the Board of Directors of Československá obchodní banka, a. s., on Relations between Related Parties

*according to the provision of Section 66a, Paragraph 9 of Act No. 513/1991 Coll., the Commercial Code, as amended (hereinafter referred to as the "ComC").*

## 1. Controlled Entity

### Československá obchodní banka, a. s.

Praha 5, Radlická 333/150, Postcode 150 57
Company ID No.: 00001350
Incorporated in the Commercial Register, Section B XXXVI, File 46, maintained at the Municipal Court in Prague (hereinafter referred to as "ČSOB" or the "Bank")

## 2. Ultimate Controlling Entity

### KBC Group NV

Belgium, 1080 Brussels, (Sint-Jans Molenbeek), Havenlaan 2

## 3. Accounting Period

This report describes relations between related parties in accordance with Section 66a, Paragraph 9 of the Commercial Code, for the accounting period from 1 January 2013 to 31 December 2013 (hereinafter referred to as the "accounting period").

In the accounting period the Bank had relations mainly with the following related entities:

| Business 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 |
| Cibank JSC | Tzar Boris III., bld. N 1, Sofia | Bulgaria |
| 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 Penzijní společnost, a. s., a member of the ČSOB group | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| ČSOB Pojišťovna, a. s., a member of the ČSOB holding | Masarykovo náměstí 1458, 532 18 Pardubice - Zelené předměstí | Czech Republic |
| ČSOB Property fund, closed-ended investment fund, a.s., a member of the ČSOB group | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| Eurincasso, s.r.o. | Benešovská 2538/40, 101 00 Praha 10 - Vinohrady | Czech Republic |

| Business Company | Business Address | |
|---|---|---|
| Hypoteční banka, a.s. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| KBC Bank NV | Havenlaan 2,<br>1080 Brussels (Sint-Jans Molenbeek) | Belgium |
| KBC Bank NV (SA) branch in Poland | Chmielna 85/87, 00-805 Warsaw | Poland |
| KBC Fund Management LTD | Joshua Dawson House,<br>Dawson street, Dublin 2 | Ireland |
| KBC Group NV (legal entity) | Havenlaan 2,<br>1080 Brussels (Sint-Jans Molenbeek) | Belgium |
| KBC Group NV Czech Branch, organizational unit | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| MOTOKOV a.s. in liquidation | Thámova 181/20, 186 00 Praha 8 | Czech Republic |
| Patria Direct, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |
| Patria Finance, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |
| Patria Finance CF, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |
| Patria Online, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |

## 4. Relations between Related Parties

**In the accounting period, ČSOB maintained relations with related parties in the following areas:**

### 4.1 Basic Banking Transactions

*The balances of these transactions are disclosed in the Separate Financial Statements for 2013 (Note: 36).*

#### a. Accounts, Deposit Products, Services of Domestic and International Payments, Domestic and International Cash Management

In the accounting period, ČSOB concluded contracts with certain of the related entities for the provision of services relating to the maintenance of various types of accounts, current and term accounts, interbank deposits, accounts for payments of deposits intended to acquire or increase participation in a company, and for the provision of the following products and services of domestic and international payments, i.e. Cash Management NightLine, Virtual Cash Pooling and Real One-Way Cash Pooling, or these services were provided in the accounting period on the basis of contracts concluded in previous accounting periods. The related entities paid or received fees for these services based on a standard price list. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

#### b. Payment Cards

In the accounting period, ČSOB concluded contracts with certain of the related entities for the issue and acceptance of payment cards, which means that payment cards were issued and their acceptance was ensured in the accounting period on the basis of contracts concluded in previous accounting periods. The related entities paid fees for these services were based on a standard price list. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

#### c. Electronic Banking

In the accounting period, ČSOB concluded contracts with certain of the related entities on the basis of which it provided the following electronic banking products: ČSOB Linka 24, ČSOB Internetbanking, ČSOB Businessbanking, ČSOB MultiCash 24 and ČSOB Edifact 24, or these products were provided in the accounting period on the basis of contracts concluded in previous accounting periods. The related entities paid fees for these services were based on a standard price list. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

**d. Cheques and Bills of Exchange**

In the accounting period, ČSOB concluded contracts with certain of the related entities for the procurement of bills of exchange and their custody and contracts for securing the bill-of-exchange program, or these services were provided in the accounting period on the basis of contracts concluded in previous accounting periods. The consideration provided by the related entities consisted of contractual fees and commissions for placing the bills of exchange. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

**e. Credit Products and Guarantees**

In the accounting period, ČSOB concluded contracts with certain of the related entities on the basis of which it provided the following credit products: overdrafts, commercial loans, revolving loans, special purpose loans, subordinated loans and current account overdrafts, and accepted and issued guarantees, confirmed or opened the letter of credits, and/or bought back claims from the letter of credits, provided guarantees, or these services were provided in the accounting period on the basis of contracts concluded in previous accounting periods. The related entities paid contractual fees, remuneration and interest for these services. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

**f. Investment Services**

In the accounting period, ČSOB concluded contracts with certain of the related entities for the purchase and sale of investment instruments, ISDA contracts, custody contracts, contracts for the settlement of transactions with investment instruments, contracts for the administration of securities, contracts of the achievement of depository, agreement on the contact bank, agreements on the authorization of fax instructions regarding settlement and administration of securities, or these services were provided in the accounting period on the basis of contracts and agreements concluded in previous accounting periods. The consideration provided by the related entities consisted of commissions and contractual fees. The contracts and agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts and agreements.

**g. Mortgage Bonds and Bonds**

In the accounting period, ČSOB concluded mandate contracts with certain of the related entities for the procurement of an issue of mortgage bonds issued in the domestic market within the framework of a bond programme, and mandate contracts for the procurement of an issue of debentures, contracts for subscription and purchase of mortgage bonds/bonds, contracts for the administration of the issue and arrangement of payments, or these services were provided in the accounting period on the basis of contracts concluded in previous accounting periods. The related entities paid contractual commissions for these services. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

**h. Receivables**

In the accounting period, ČSOB concluded contracts with certain of the related entities for the administration or assigning of receivables, or these services were provided to Bank in the accounting period on the basis of contracts concluded in previous accounting periods. The Bank provided contractual commissions to related entities for these services. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

## 4.2 Other Relations

*The balances of these transactions are disclosed in the Separate Financial Statements for 2013 (Note: 36).*

### 4.2.1 Contracts

**a. Insurance Contracts**

In the accounting period, ČSOB concluded insurance contracts with certain of the related entities and, in some cases, the related entities performed activities in the accounting period on the basis of insurance contracts concluded in previous accounting periods. The consideration exchanged with the related entities consisted of insurance and insurance compensation. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

### b. Lease and Rent Contracts

In the accounting period, ČSOB concluded contracts with certain of the related entities for the rent of non-residential areas, parking places and movable assets and, in some cases, the related entities performed activities in the accounting period on the basis of rental contracts concluded in previous accounting periods. The consideration exchanged with the related entities consisted of contractual prices or the lease of certain items. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

### c. Co-operation Agreements – Employee Benefits

In the accounting period, ČSOB concluded co-operation agreements - employee benefits with certain of the related entities and, in some cases, the related entities performed activities in the accounting period on the basis of agreements relating to this area concluded in previous accounting periods. The consideration exchanged with the related entities consisted of the provision of employee benefits. The agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these agreements.

### d. Co-operation Agreements – Selling Products and Services

In the accounting period, ČSOB concluded cooperation agreements, framework, mandate and commission agent´s contracts with certain of the related entities whose subject was, in particular, cooperation in the areas of product sales, products sales agency, sales support and use technology, consultancy, opportunity-seeking and, in some cases, the related entities performed activities in the accounting period on the basis of agreements concluded in previous accounting periods. The consideration exchanged with the related entities consisted of co-operation, contractual commissions, contractual fees or selling products. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

In addition to the co-operation agreements, in the accounting period ČSOB concluded with certain of the related entities contracts for labour-law relations and use employees within the group, agreements on personal data processing, maintenance confidentiality agreements, agreements on the transmission of information, agreements on mutual rights and duties in connection with the co-operation agreements, and, in some cases, the related entities performed activities in the accounting period on the basis of agreements concluded in previous accounting periods. The consideration exchanged with the related entities consisted of the provision of information and confidentiality. The contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts.

### e. Co-operation Agreements – Observance of Tax Obligation (VAT Grouping)

On 1 January 2010, ČSOB concluded agreement with certain of the related entities (ČMSS, ČSOB AM/IS, ČSOB Penzijní společnost, ČSOB Pojišťovna, Hypoteční banka, KBC IT CZ) for co-operation on the common fulfilment of tax obligation (VAT). The consideration provided by the related entities consisted of common fulfilment of tax obligation. The agreement was concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of this agreement.

### f. Agreements on IT Services

In the accounting period, ČSOB concluded agreements with certain of the related entities for providing ICT services, and, in some cases, the related entities performed activities in the accounting period on the basis of contracts concluded in previous accounting periods. The consideration provided by the related entities consisted of contractual commissions. The contracts and agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts and agreements.

### g. Agreements on Providing Services – Call Centre

In the accounting period, ČSOB concluded agreements with certain of the related entities for providing Call centre services, and, in some cases, the related entities performed activities in the accounting period on the basis of contracts concluded in previous accounting periods. The consideration provided by the related entities consisted of contractual commissions. The contracts and agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts and agreements.

**h. Agreements on Providing Services – Back Office**

In the accounting period, ČSOB concluded agreements with certain of the related entities for providing services in the area of back-office and supporting processes, i.e. co-operation in risk management, development of models, management consulting, central procurement, providing services in the area of accounting and taxes, processing of foreign payments and, in some cases, the related entities performed activities in the accounting period on the basis of contracts concluded in previous accounting periods. The consideration provided by the related entities consisted of contractual commissions and consultations. The contracts and agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts and agreements.

**i. Agreements on Providing Services – Facilities Management**

In the accounting period, ČSOB concluded agreements with certain of the related entities for providing services in the area of facilities management, i.e. accounting and assets administration, food vouchers and catering, accommodation, postal services, documents archiving, telephone exchange, and, in some cases, the related entities performed activities in the accounting period on the basis of contracts concluded in previous accounting periods. The consideration provided by the related entities consisted of contractual commissions. The contracts and agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts and agreements.

Simultaneously in the accounting period, ČSOB concluded agreements with certain of the related entities of services in the area of facilities management, i.e. fleet management and parking administrations, when these services are provided to Bank by some related entities and, in some cases, these services were provided to Bank in the accounting period on the basis of contracts concluded in previous accounting periods. The Bank provided contractual commissions to related entities for these services. The contracts and agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts and agreements.

**j. Agreements on Providing Services – Internal Audit**

In the accounting period, ČSOB concluded agreements with certain of the related entities for co-operation and providing services in the area of internal audit and compliance, and, in some cases, the related entities performed activities in the accounting period on the basis of contracts concluded in previous accounting periods. The consideration provided by the related entities consisted of services and contractual commissions. The contracts and agreements were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these contracts and agreements.

### 4.2.2 Dividends

In the accounting period the following related entities paid dividends to ČSOB: BANIT, ČMSS, ČSOB Factoring, Hypoteční banka, ČSOB Advisory, ČSOB Penzijní společnost, ČSOB Leasing, ČSOB Pojišťovna, ČSOB AM/IS, První certifikační autorita and CBCB.

ČSOB paid out a dividend to KBC Bank.

### 4.2.3 Other Measures

In the accounting period, ČSOB further adopted a Resolution of the sole shareholder/partner on behalf of some related entities (subsidiaries where the Bank is the sole shareholder/partner) on the following:

- Approval of the year-end financial statements,
- Settlement of profit and dividends pay-out,
- Election of Board members and their remuneration,
- Change of the Articles of Association,
- Approval of the status of certain subsidiaries,
- Increase/decrease of share capital and/or share premium,
- Establishment of a company Radlice Rozvojová, a.s.; the Bank settled part of the subscribed capital in the form of land.

Resolutions and related contracts were concluded under standard business terms and conditions. The Bank incurred no damage from the fulfilment of these Resolutions and related contracts.

## 5. Conclusion

The Board of Directors notes that this Report was treated in the statute of limitation.

The Board of Directors of ČSOB states that it has exercised due professional care in determining the range of related parties for the purposes of this report. In particular, entities controlling ČSOB were asked about the range of parties controlled by these entities.

The Board of Directors of ČSOB believes that the monetary benefits and, where applicable, the considerations within the framework of relations between the related parties described in this report were carried out at prices determined on an arm's length basis, similar to relations with other non-related entities, and that ČSOB incurred no damage from relations described above.

This Report was submitted to review of the Supervisory Board of ČSOB.

In Prague, 27 March 2014

Československá obchodní banka, a. s.

On behalf of the Board of Directors

**Pavel Kavánek**
Chairman of the Board of Directors
and Chief Executive Officer

**Bartel Puelinckx**
Member of the Board of Directors
and Chief Finance Officer

# ČSOB Securities

## Shares

### Shares and Share Capital of ČSOB

| | as at 31 December 2013 |
|---|---|
| ISIN | CZ0008000288 |
| Class | Ordinary shares |
| Type | Bearer shares |
| Edition | Book-entered |
| Number of shares | 292,750,001 |
| Nominal value | CZK 20 |
| Total issue volume | CZK 5,855,000,020 |
| **Amount of share capital** | **CZK 5,855,000,020** |
| Paid up | 100% |

**On 11 July 2013, KBC Bank NV** as ČSOB's sole shareholder decided **on increase in share capital of ČSOB** by CZK 20 from current CZK 5,855,000,000 **to CZK 5,855,000,020***, under the following conditions:

- increase of share capital was made by subscription of one piece of common uncertificated bearer share with a nominal value of CZK 20,
- issue price of the subsribed share is CZK 8,000,000,000, whereas CZK 7,999,999,980 is a share premium.

* Recorded by an entry in the Commercial Register on 23 July 2013.

**KBC Bank NV**, with its registered address at: Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek), Belgium, **is the sole shareholder of ČSOB**.

ČSOB has not issued any convertible bonds or priority bonds as defined by Section 160 of the Commercial Code. In 2013, ČSOB neither held any own shares, nor issued stock certificates.

**ČSOB shares are not publicly tradable on any official regulated market in either an EU member state, or an EEC member state.**

### Rights Attached to ČSOB Shares

**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 an Extraordinary Meeting of Shareholders to discuss proposed matters. This right only pertains to a shareholder or shareholders who hold shares with a total nominal value exceeding 3% of the share capital.

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 trough liquidation.

**Voting rights attached to ČSOB shares are unlimited.**

# Bonds

*(outstanding)*

In the Czech Republic, ČSOB is an issuer of bonds and mortgage 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.

**By 31 December 2013, ČSOB had issued the following bond issues under the bond issuance program in the Czech Republic:**

| Issue Name | ISIN | Issue Date | Volume of Bonds Issued (Nominal Value) | |
|---|---|---|---|---|
| Mortgage bond ČSOB 4.60%/2015 | CZ0002000706 | 15. 11. 2005 | CZKm | 1,300 |
| Bond ČSOB VAR/2018 | CZ0003701799 | 22. 12. 2008 | CZKm | 10 |
| Bond ČSOB Inflace I/2015 (Tranche no. 1) | CZ0003702292 | 10. 3. 2010 | CZKm | 170 |
| Bond ČSOB koš akcií/2015 (Tranche no. 1) | CZ0003702441 | 27. 10. 2010 | CZKm | 121.7 |
| Bond ČSOB ZERO USD III/2014 | CZ0003702524 | 13. 1. 2011 | USDm | 10 |
| Bond ČSOB 3M PRIBOR/2016 (Tranche no. 1) | CZ0003702540 | 2. 3. 2011 | CZKm | 149 |
| Bond ČSOB Inflace II/2016 (2 Tranches) | CZ0003702789 | 17. 3. 2011 | CZKm | 630 |
| Bond ČSOB Měny II/2016 (Tranche no. 1) | CZ0003702821 | 5. 5. 2011 | CZKm | 280 |
| Bond ČSOB koš akcií II/2016 (Tranche no. 1) | CZ0003702839 | 9. 6. 2011 | CZKm | 111.3 |
| Bond ČSOB likvidní IV/2017 (3 Tranches) | CZ0003703050 | 2. 2. 2012 | CZKm | 2,400 |
| Bond ČSOB 3M PRIBOR II/2017 (Tranche no. 1) | CZ0003703183 | 29. 3. 2012 | CZKm | 210 |
| Bond ČSOB likvidní VI/2017 (2 Tranches) | CZ0003703472 | 6. 8. 2012 | CZKm | 2,000 |

The bond issuance program was closed. Any issue of bonds or any bond programe are not currently prepared.

**By 31 December 2013, ČSOB issued the following investment certificate issues under the certificate issuance program (public or non public) in the Czech Republic:**

| Issue Name | ISIN | Issue Date | Volume of Investment Certificates Issued (Nominal Value | |
|---|---|---|---|---|
| ČSOB Investment certificate I. (Tranche no. 1) | CZ0000300157 | 27. 3. 2013 | CZKm | 212.08 |
| ČSOB Investment certificate II. (Tranche no. 1) | CZ0000300207 | 29. 8. 2013 | CZKm | 167.75 |
| ČSOB Investment certificate III. (Tranche no. 1) | CZ0000300215 | 19. 9. 2013 | CZKm | 209.74 |
| ČSOB Investment certificate V. (Tranche no. 1) | CZ0000300256 | 25. 10. 2013 | CZKm | 59.30 |
| ČSOB Investment certificate VI. (Tranche no. 1) | CZ0000300264 | 30. 10. 2013 | EURm | 4.121 |
| ČSOB Investment certificate IV. credit | CZ0000300249 | 1. 11. 2013 | CZKm | 500.00 |
| ČSOB Investment certificate VII. (Tranche no. 1) | CZ0000300280 | 4. 12. 2013 | CZKm | 154.12 |
| ČSOB Investment certificate VIII. (Tranche no. 1) | CZ0000300298 | 16. 12. 2013 | CZKm | 189.65 |

**In the first three months 2014, ČSOB issued the following certificates issues under the certificate issuance program (non public) in the Czech Republic:**

| Issue Name | ISIN | Issue Date | Volume of Investment Certificates Issued (Nominal Value) | |
|---|---|---|---|---|
| ČSOB Investment certificate IX. (Tranche no. 1) | CZ0000300306 | 19. 2. 2014 | CZKm | 135.61 |
| ČSOB Investment certificate X. (Tranche no. 1) | CZ0000300314 | 12. 3. 2014 | USDm | 4.983 |
| ČSOB Investment certificate XI. (Tranche no. 1) | CZ0000300322 | 19. 3. 2014 | CZKm | 134.50 |

**The Bond ČSOB VAR/2018 bond is listed at the Regulated Market of the Prague Stock Exchange**; trading started on 22 December 2008. The remaining bonds, mortgage bonds and investment certificates are unlisted.

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.

**The bond issuance program's prospectus, amendments thereto and pricing supplements and the prospectus of investment certificates as well as the prospectus of the Bond ČSOB VAR/2018 are available at ČSOB's website www.csob.cz.**

# Activity of ČSOB

ČSOB is active as a universal bank in the Czech Republic.

## Legislation Governing ČSOB

**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 Act on Business Activities on the Capital Market (also known as the Act on Undertakings on the Capital Market) and the Commercial Code (and by the Corporations Act effective from 1 January 2014).

**A single banking licence** granted to ČSOB in accordance with the Banking Act by the decision of the CNB of 28 July 2003, reference number 2003/3350/520, is of fundamental importance for ČSOB's business activities. In addition, ČSOB holds a certificate of registration in the register of insurance brokers and independent loss adjusters of insured accidents confirming that it was entered in the register as a tied **insurance broker** under number 038614VPZ on 20 March 2006.

## Main Areas of Activities

**ČSOB's scope of business is defined in the ČSOB Articles of Association** (in the part "Corporate Activities and Organisation of the Company – 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.

Since 1 June 2009, ČSOB has been using **outsourced ICT services** - until 30 June 2013, provided by KBC Global Services Czech Branch, organizační složka [1] (KBC GS CZ); since 1 July 2013, after the merger of KBC Group NV and KBC Global Services NV into one legal entity, provided by KBC Group NV Czech Branch, organizační složka [2] (KBC IT CZ).

Companies of the ČSOB group (for example Hypoteční banka, ČSOB AM/IS, ČSOB Penzijní společnost, ČSOB Leasing, ČSOB Factoring and also ČSOB Pojišťovna) use outsourced ICT services provided by KBC GS CZ and by KBC IT CZ since 1 July 2013.

*1) KBC GS CZ, Company Reg. No. 285 16 869, registered seat at Radlická 333/150, 150 57 Prague 5, was part (so-called „organizational unit") of the Belgian KBC Global Services NV.*
*2) KBC IT CZ, Company Reg. No. 285 16 869, registered seat at Radlická 333/150, 150 57 Prague 5, is part (so-called „organizational unit") of the Belgian KBC Group NV.*

## 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 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

– is available in Notes 27 and 33 of the Notes to the Separate Financial Statements for the year 2013 according to EU IFRS and in Notes 29 and 35 of the Notes to the Consolidated Financial Statements for the year 2013 according to EU IFRS.

**The most significant ČSOB's court disputes as at 31 December 2013** are shown in the following tables including the dispute amount (without accessions).

**I. Litigation Initiated by ČSOB** (the Plaintiff)

| | Counterparty of the Dispute | Receivable (CZKm) |
|---|---|---|
| 1. | Czech Republic – Ministry of Finance* | 1,420 |

**II. Litigation against ČSOB** (the Defendant)

| | Counterparty of the Dispute | Liability (CZKm) |
|---|---|---|
| 1. | ICEC-HOLDING, a.s. | 11,893 |
| 2. | imAGe Alpha, a.s.* | 11,227 |
| 3. | ALTIA Plus international (formerly JUDr. Věslav Németh) | 1,682 |
| 4. | Bankruptcy Trustee of Chemapol Group, a.s.* | 1,450 |

Legal dispute indicated in list I represent no risk even the event of a potential defeat.

According to the Bank, legal disputes in list II do not constitute any risk, given their absolute unreasonableness. In addition, legal disputes with number 1 and 3 in list II have the risk of any potential defeat covered by the CNB's indemnity issued in connection with the sale of the IPB enterprise, according to the Bank.

** Legal dispute number 1 in list I and legal disputes number 2 and 4 in list II were closed in the first quarter of 2014.*

# Research and Development Expenses

In 2013, ČSOB had outlays of CZK 216 m for research and development. 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.

# Other Information

## Annex to Additional Information

*Information according to Annex No. 30 of Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms*

## Information Published within this Annual Report

| Information | Reference [1] |
|---|---|
| Important Events and Significant Changes in 2013 | Report of the Board of Directors<br>Managing and Supervisory Bodies<br>Corporate Governance Policy<br>Note 3 [2] |
| New Products and Services Introduced in 2013 | Report of the Board of Directors |
| Description of Markets where ČSOB Competes | Company Profile<br>Report of the Board of Directors |
| Profit Distribution | Note 14 |
| Activities Undertaken in the Area of Environmental Protection [3] | Corporate Social Responsibility |
| Information on Entities Included into the ČSOB Consolidated Financial Statements as at 31 December 2013 | Companies of the ČSOB group<br>Note 3 [2] |
| Expected Economic and Financial Situation of ČSOB in 2014 | 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 2013 according to EU IFRS (unless stated otherwise).*
*2) The content refers to a note in Notes to the Consolidated Financial Statements for the year 2013 according to EU IFRS.*
*3) Together with this Annual Report, ČSOB also publishes the ČSOB Social Responsibility Report 2013.*

## Remuneration Charged by Auditors for 2013

*Information in accordance with the Act No. 256/2004 Coll., Act on Business Activities on the Capital Market (also known as the Act on undertakings on the capital market), section 118, paragraph 4, provisions k)*

| Services Provided (CZKths) | ČSOB | Consolidated ČSOB Unit |
|---|---|---|
| Statutary audit of annual financial statements | 17,970 | 29,866 |
| Other reviewed services | 298 | 298 |
| Tax advisory | 0 | 0 |
| Other non-audit services | 368 | 4,176 |
| Training/consultation | 5 | 5 |
| **Total** | **18,641** | **34,345** |

## Information about the Contribution to the Securities Traders Guarantee Fund

*Information in accordance with the Act No. 256/2004 Coll., Act on Business Activities on the Capital Market (also known as the Act on undertakings on the capital market), section 16, paragraph 1.*

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 2013 (CZKths) | ČSOB | Consolidated ČSOB Unit* |
|---|---|---|
| Basis for calculation of the contribution | 878,364 | 878,364 |
| The contribution | 17,567 | 17,567 |

* *Contribution of ČSOB AM/IS (CZK 2,292 ths) 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 2013.*

## Events after the Reporting Period

| Chapter | Part |
|---|---|
| Companies of the ČSOB Group | Companies of the ČSOB Group |
| Corporate Governance | Managing and Supervisory Bodies, ČSOB's Organisation Chart |
| Additional Information | Bonds; Governmental, Legal or Arbitration Proceedings |

## Information on the Publication of the ČSOB Annual Report

**ČSOB will publish its Annual Report 2013 on its Internet website at www.csob.cz.**

The **Czech National Bank** will add the ČSOB Annual Report 2013 to the collection of deeds of the **Register of Companies** pursuant to Section 21a of the Accounting Act.

## Annex to Additional Information

# Information according to Annex No. 30 of Decree No. 123/2007 Coll.,

### stipulating the prudential rules for banks, credit unions and investment firms

## 1. Information on the Capital of the Regulated Consolidated Unit

### Summary of Conditions and Main Features of the Capital and Its Constituents

The rules for capital adequacy calculation of the Regulated consolidated unit are stipulated by the Czech National Bank's Decree No. 123/2007 Coll. on the rules of prudent business carried out by banks, savings and loan cooperatives and securities traders (as amended by Decree No. 282/2008 Coll., No. 380/2010 Coll., No. 89/2011 Coll. and No.187/2012 Coll.); the Regulation also contains rules for definition of the Regulated consolidated unit.

The total authorized share capital as at 31 December 2013 equals CZK 5,855,000,020 and was composed of 292,750,001 ordinary shares with a nominal value of CZK 20 each. Share premium was CZK 15,509 m in aggregate.

To support the capital structure of its group, ČSOB received subordinated debt in nominal amount of CZK 12 bn in two tranches: CZK 5 bn in September 2006 with the maturity date falling on 29 September 2016 and CZK 7 bn in February 2007 with the maturity date falling on 28 March 2017. In September 2012, ČSOB repaid prematurely CZK 4 bn of the first tranche of subordinated debt. ČSOB has agreed with creditor to repay remaining subordinated debt in the amount CZK 8 bn in August 2013.

Repayment of subordinated debt was fully offset by the increase in the share premium account of the regulated consolidated group of CZK 8,000 m to a total amount of CZK 15,509 m.

During the year 2013 the increase of the regulatory consolidated capital amounted to CZK 3.1 bn.

The amount of the total regulatory capital was positively influenced by the decision of the sole shareholder, KBC Bank, to increase retained profit from previous periods of part of the profit of the year 2012 in the amount of CZK 2.4 bn.

The aggregate amount of capital also positively influenced by the increase of the coverage of expected credit losses in IRB in amount CZK 0.8 bn.

## Information on Capital of the Regulated Consolidated Unit

| Information on Capital (CZKths) | | 31. 12. 2013 | 31. 12. 2012 |
|---|---|---|---|
| **1.** | **Original capital** (Tier 1) | **55,245,101** | **44,975,057** |
| 1.1 | Common equity Tier 1 | 55,245,101 | 44,975,057 |
| | Paid-up basic capital registered in the Commercial Register | 5,855,000 | 5,855,000 |
| | Own shares | 0 | 0 |
| | Share premium | 15,508,552 | 7,508,552 |
| | Mandatory reserve funds | 18,686,648 | 18,686,648 |
| | Retained profit from previous periods | 18,219,531 | 15,864,091 |
| | Minority interests | 215,404 | 241,158 |
| | Goodwill from consolidation | (96,511) | 0 |
| | Resulting exch. rate differences from consolidation | 0 | 0 |
| | Goodwill other than from consolidation | (2,511,289) | (2,688,910) |
| | Intangible assets other than goodwill | (632,232) | (491,480) |
| | Negative valuation difference from real value changes in AFS shares | (1) | (1) |
| 1.2 | Additional Capital Tier 1 | 0 | 0 |
| | Hybrid Instruments | 0 | 0 |
| **2.** | **Additional capital** (Tier 2) | **75,875** | **7,982,775** |
| 2.1 | Dominant Tier 2 | 75,875 | 0 |
| | Excess in the coverage of expected credit losses in IRB (Internal Rating-based) approach | 75,875 | 0 |
| | Excess on the limits for hybrid instruments | 0 | 0 |
| 2.2 | Additional Tier 2 | 0 | 7,982,775 |
| | Subordinated debt | 0 | 7,982,775 |
| **3.** | **Total capital to cover market risk** (Tier 3) | **0** | **0** |
| **4.** | **Items deductible from original and additional capital** (from Tier 1 + Tier 2) | **(15,882)** | **(788,226)** |
| | *In which IRB Provision shortfall and IRB equity expected loss amount* | (14,752) | (787,096) |
| **Total regulatory capital** | | **55,305,095** | **52,169,607** |

## 2. Information on Capital Requirement of the Regulated Consolidated Unit

### Amount of the Regulatory Capital Requirements of the Regulated Consolidated Unit

| Capital Requirements (CZKths) | | 31. 12. 2013 | 31. 12. 2012 |
|---|---|---|---|
| **1.** | **Credit risk total** | **22,475,160** | **21,668,694** |
| 1.1 | Total capital requirements for credit risks with standardized approach (STA) | 806,373 | 2,255,625 |
| | Exposures to central governments and central banks | 0 | 0 |
| | Exposures to institutions | 22,126 | 142,868 |
| | Exposures to enterprises | 494,442 | 917,227 |
| | Retail exposures | 20,415 | 865,113 |
| | Share exposures | 1,565 | 8,426 |
| | Other exposures | 267,827 | 321,990 |
| | Securitized exposures | 0 | 0 |
| 1.2 | Total capital requirement to credit risk subject to IRB approach | 21,668,787 | 19,413,069 |
| | Exposures to central governments and central banks | 151,572 | 155,904 |
| | Exposures to institutions | 908,406 | 955,680 |
| | Exposures to enterprises | 8,559,821 | 9,559,477 |
| | Retail exposures | 8,222,010 | 6,630,917 |
| | Share exposures | 181,936 | 137,726 |
| | Securitized exposures | 0 | 0 |
| | Other exposures | 3,645,041 | 1,973,366 |
| **2.** | Capital requirement **to settlement risk** | **0** | **0** |
| **3.** | Capital requirement **to position currency and commodity risk** | **1,410,393** | **1,203,739** |
| **4.** | Capital requirement **to operational risk** | **4,523,595** | **4,516,351** |
| **5.** | Capital requirement **to trading portfolio exposure risk** | **0** | **0** |
| **6.** | Capital requirement **to trading portfolio to other tools** | **0** | **0** |
| **7.** | **Other and transitional** capital requirement **resulting from transition to IRB or AMA approach** | **0** | **0** |
| **Total capital requirement** | | **28,409,147** | **27,388,784** |

## 3. ČSOB's Ratios (Unconsolidated)

| Ratio | | 31. 12. 2013 | 31. 12. 2012 |
|---|---|---|---|
| Capital adequacy | % | 15.32 | 14.44 |
| Return on average assets (ROAA) | % | 1.66 | 1.90 |
| Return on average equity (ROAE) | % | 33.47 | 43.66 |
| Assets per employee | CZKths | 141,302 | 122,073 |
| Administrative expenses per employee* | CZKths | 1,809 | 1,782 |
| Profit after income tax per employee* | CZKths | 2,199 | 2,316 |

** Annualized.*

# Statement of the Supervisory Board of ČSOB

The Supervisory Board has performed its tasks in compliance with Articles 197–201 of the Commercial Code, as amended, ČSOB's Articles of Association and the Supervisory Board's Rules of Conduct. The Board of Directors has submitted regular reports on ČSOB's activities and its financial situation to the Supervisory Board.

The Separate Financial Statements of the Bank and Consolidated Financial Statements of the Bank and its subsidiaries (the "ČSOB group") have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

The Separate Financial Statements were audited by Ernst & Young Audit, s.r.o. The auditors have opined that the Separate Financial Statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2013, and 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 auditors have also opined that the Consolidated Financial Statements present fairly, in all material respects, the financial position of the ČSOB group as at 31 December 2013, and 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 Supervisory Board has reviewed the 2013 Separate Annual Financial Statements and has accepted the results of the audit of the 2013 Separate Annual Financial Statements and has recommended to the General Meeting to approve them.

In Prague, 14 April 2014

# Decision of the ČSOB's Sole Shareholder

**Rozhodnutí jediného akcionáře při výkonu působnosti valné hromady**

ve smyslu ustanovení § 12 zákona č. 90/2012 Sb., zákona o obchodních korporacích

**KBC Bank NV**, se sídlem v Bruselu, Havenlaan 2, PSČ 1080, Belgické království (dále jen „**Jediný akcionář**"), společnost založená a existující podle práva Belgického království, zapsaná v Rejstříku právnických osob Brusel pod číslem 0462.920.226,

jako jediný akcionář společnosti **Československá obchodní banka, a. s.**, se sídlem Radlická 333/150, PSČ 150 57 Praha 5, Česká republika, IČO 000 01 350, zapsané v obchodním rejstříku vedeném Městským soudem v Praze, oddíl BXXXVI, vložka 46 (dále jen „**Společnost**"), tímto rozhoduje takto:

(a) schvaluje řádnou nekonsolidovanou účetní závěrku Společnosti k 31. prosinci 2013 a řádnou konsolidovanou účetní závěrku Společnosti k 31. prosinci 2013 sestavené podle Mezinárodních standardů účetního výkaznictví ve znění přijatém Evropskou unií;

(b) bere na vědomí:

(i) zprávu představenstva Společnosti o podnikatelské činnosti Společnosti a o stavu jejího majetku za rok 2013, a

(ii) zprávu o kontrolní činnosti dozorčí rady Společnosti v roce 2013 a o přezkoumání řádné účetní závěrky sestavené k 31. prosinci 2013; a

(c) schvaluje rozdělení nekonsolidovaného čistého zisku Společnosti za rok 2013 uvedeného v řádné nekonsolidované účetní závěrce Společnosti k 31. prosinci 2013 v celkové výši 14 333 810 745,26 Kč následujícím způsobem:

(i) část nekonsolidovaného čistého zisku Společnosti za rok 2013 uvedeného v řádné nekonsolidované účetní závěrce Společnosti k 31. prosinci 2013 v celkové výši 8 109 175 027,70 Kč se rozděluje mezi akcionáře;

(ii) část nekonsolidovaného čistého zisku Společnosti za rok 2013 uvedeného v řádné nekonsolidované účetní závěrce Společnosti k 31. prosinci 2013 v celkové výši 6 224 635 717,56 Kč se převádí na účet nerozdělený zisk z minulých

**Decision of the Sole Shareholder in Exercising the Powers of the General Meeting**

in accordance with Sec. 12 of the Act No. 90/2012 Coll., the corporations act

**KBC Bank NV,** with its registered office at Brussels, Havenlaan 2, Post Code 1080, Belgium (hereinafter referred to as the "**Sole Shareholder**"), a company founded and organised under the Belgian law, registered in the Register of Legal Persons under number 0462.920.226,

as a sole shareholder of **Československá obchodní banka, a. s.**, with its registered office at Prague 5, Radlická 333/150, Postal Code 150 57, the Czech republic, having Identification Number: 000 01 350, registered with the Commercial Register maintained by the Municipal Court in Prague, Section BXXXVI, Insert No. 46 (hereinafter referred to as the "**Company**"), hereby decides as follows:

(a) approves regular separate financial statements of the Company for the year ended on 31 December 2013 and regular consolidated financial statements of the Company for the year ended on 31 December 2013 prepared in accordance with IFRS in wording passed by the EU, and

(b) takes knowledge of:

(i) Company´s Board of Directors report on Company´s business activity and state of its assets for the year of 2013, and

(ii) Company´s Supervisory Board Report on its control activities during the year of 2013 and review of Company´s regular financial statements as of the day of 31st December 2013; and

(c) approves distribution of the non-consolidated net profit for the year 2013 as stated in the regular non-consolidated financial statements of the Company for the year ended on 31 December 2013 in the total amount of CZK 14 333 810 745.26 as follows:

(i) the part of non-consolidated net profit of the Company for the year 2013 as stated in the regular non-consolidated financial statements of the Company for the year ended on 31 December 2013 in the amount of CZK 8 109 175 027.70 shall be distributed to the shareholders.

(ii) the part of non-consolidated net profit of the Company for the year 2013 as stated in the regular non-consolidated financial statements of the Company for the year ended on 31 December 2013 in the amount of CZK let.

6 224 635 717.56 shall be allocated to the account retained earnings from the previous years.

Jedinému akcionáři bude vyplacen podíl na zisku ve výši 27,70 Kč na akcii. Nárok na výplatu podílu na zisku vzniká okamžikem tohoto rozhodnutí. Podíl na zisku musí být vyplacen do 30 dnů ode dne přijetí tohoto rozhodnutí.

The Sole Shareholder shall be paid the share of profit in the amount of CZK 27.70 per share. The claim for share of profit is due when this decision is adopted. The share of profit shall be paid no later than 30 days from the claim is due.

V případě rozporu mezi oběma jazykovými verzemi je rozhodující verze česká.

In case of any discrepancy between both language versions, the Czech one shall prevail.

V Bruselu dne 14/04/2014.

Brussels, on the day of 14/04/2014.

**KBC Bank NV**

Jméno:
Výkonný ředitel

John Hollows
Executive Director

Jméno:
Výkonný ředitel

Luc Popelier
Executive Director

**KBC Bank NV**

Name:
Executive Director

John Hollows
Executive Director

Name:
Executive Director

Luc Popelier
Executive Director

# Sworn Statement

## Persons Responsible for the ČSOB Annual Report 2013

hereby declare that, to their best knowledge, the ČSOB Annual Report 2013 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, 24 April 2014

Československá obchodní banka, a. s.

**Pavel Kavánek**
Chairman of the Board of Directors
and Chief Executive Officer

**Bartel Puelinckx**
Member of the Board of Directors
and Chief Finance Officer

# INDEPENDENT AUDITOR'S REPORT ON THE ANNUAL REPORT AND ON THE RELATED PARTIES REPORT

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INDEPENDENT AUDITOR'S REPORT

To the Shareholder of Československá obchodní banka, a. s.:

I. We have audited the consolidated financial statements of Československá obchodní banka, a. s., and its subsidiaries (or "the Bank") as at 31 December 2013 presented in the annual report of the Bank on pages 56 - 155 and our audit report dated 27 March 2014 is presented in the annual report of the Bank on pages 54 - 55. We have also audited the separate financial statements of Československá obchodní banka, a. s. (or "the Bank") as at 31 December 2013 presented in the annual report of the Bank on pages 158 - 256 and our audit report dated 27 March 2014 is presented in the annual report of the Bank on pages 156 - 157 (both referred to further as "financial statements").

II. We have also audited the consistency of the annual report with the financial statements described above. The management of Československá obchodní banka, a. s. is responsible for the accuracy of the annual report. Our responsibility is to express, based on our audit, an opinion on the consistency of the annual report with the financial statements.

We conducted our audit in accordance with International Standards on Auditing and the related implementation guidance issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the information presented in the annual report that describes the facts reflected in the financial statements is consistent, in all material respects, with the financial statements. We have checked that the accounting information presented in the annual report of the Bank on pages 1 - 50 and 258 - 280 is consistent with that contained in the audited financial statements as at 31 December 2013. Our work as auditors was confined to checking the annual report with the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Bank. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting information presented in the annual report is consistent, in all material respects, with the financial statements described above.

III. In addition, we have reviewed the accuracy of the information contained in the report on related parties of Československá obchodní banka, a. s. for the year ended 31 December 2013 presented in the annual report of the Bank on pages 258 - 263. As described in report on related parties, the Company prepared this report in accordance with Commercial Code. The management of Československá obchodní banka, a. s. is responsible for the preparation and accuracy of the report on related parties. Our responsibility is to issue a report based on our review.

We conducted our review in accordance with the applicable International Standard on Review Engagements and the related Czech standard No. 56 issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the review to obtain moderate assurance as to whether the report on related parties is free from material misstatement. The review is limited primarily to enquiries of the Bank personnel, to analytical procedures applied to financial data and to examining, on a test basis, the accuracy of information, and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the report on related parties of Československá obchodní banka, a. s. for the year ended 31 December 2013 is materially misstated.

Ernst & Young

Ernst & Young Audit, s.r.o.
License No. 401
Represented by

D. Burnham

Douglas Burnham
Partner

Zedník

Jan Zedník
Auditor, License No. 2201

24 April 2014
Prague, Czech Republic

# ABBREVIATIONS

| Abbreviation | Business Company |
|---|---|
| ČSOB<br>the Bank | Československá obchodní banka, a. s. |
| PSB | Poštovní spořitelna (Postal Savings Bank; part of ČSOB) |

| Abbreviation | Business Company |
|---|---|
| Auxilium | Auxilium, a.s. |
| 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 |
| 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., a member of the ČSOB group |
| ČSOB AM/IS | ČSOB Asset Management, a.s., investment company |
| ČSOB Factoring | ČSOB Factoring, a.s. |
| ČSOB IBS | ČSOB Investment Banking Services, a.s., a member of the ČSOB group |
| ČSOB IS / ČSOB Investiční společnost | ČSOB Investiční společnost, a.s., a member of the ČSOB group |
| ČSOB Leasing | ČSOB Leasing, a.s. |
| ČSOB Leasing pojišťovací makléř | ČSOB Leasing pojišťovací makléř, s.r.o. |
| ČSOB PF Progres | ČSOB Penzijní fond Progres, a. s., a member of the ČSOB group |
| 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, closed-ended investment fund, a.s.,<br>a member of the ČSOB group |
| ČSOB SK | Československá obchodná 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 CZ | KBC Group NV Czech Branch, organizational unit |
| KBC GS | KBC Global Services NV |
| KBC GS CZ | KBC Global Services Czech Branch, organizational unit |
| KBC Insurance / KBC Verzekeringen | KBC Insurance NV (i.e. KBC Verzekeringen NV) |
| KBC IT CZ | KBC Group NV Czech Branch, organizational unit |
| KBC Lease Holding | KBC Lease Holding NV |
| KBC Participations Renta | KBC Participations Renta SA |
| KBC Participations Renta C | KBC Participations Renta C SA |
| KBC Securities | KBC Securities NV |
| Merrion Properties | Merrion Properties s.r.o. |
| MF CZ | Ministry of Finance of the Czech Republic |
| Motokov | MOTOKOV a.s. in liquidation |
| Patria Direct | Patria Direct, a.s. |
| Patria Finance | Patria Finance, a.s. |
| Property LM | Property LM, s. r. o. |
| Property Skalica | Property Skalica, s.r.o. |
| Radlice Rozvojová | Radlice Rozvojová, a.s. |
| Transformed fund Stabilita | Transformovaný fond Stabilita ČSOB Penzijní společnosti, a. s.,<br>a member of the ČSOB group |

## ČSOB Group Unaudited Financial Results Releases

*(In accordance with EU IFRS)*

| Financial Results | | Date of Release |
|---|---|---|
| as at 31 December 2013 | 4Q / FY 2013 | 13 February 2014 |
| as at 31 March 2014 | 1Q 2014 | 15 May 2014 |
| as at 30 June 2014 | 2Q / 1H 2014 | 7 August 2014 |
| as at 30 September 2014 | 3Q / 9M 2014 | 13 November 2014 |
| as at 31 December 2014 | 4Q / FY 2014 | 12 February 2015 |

*Note: This schedule is indicative only; terms might be subject to change during the year.*

# CONTACT DETAILS

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