# ANNUAL REPORT 2017

Československá obchodní banka, a. s.

| | |
|---|---|
| **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 |
| Data box | 8qvdk3s |
| Telephone | +420 224 111 111 |
| Internet address | https://www.csob.cz |
| E-mail | info@csob.cz |
| 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 | 2017 | 2016 | 2015 |
|---|---|---|---|
| **Financial Statements Figures** | | | |
| ***Balance sheet at the year end*** *(CZKm)* | | | |
| Total assets | 1,315,590 | 1,085,527 | 956,325 |
| Loans and receivables[1)] | 1,062,201 | 782,099 | 574,413 |
| Deposits received from other than credit institutions | 744,448 | 676,162 | 621,927 |
| Debt securities in issue | 350,136 | 222,997 | 166,492 |
| Shareholders' equity[2)] | 93,703 | 88,549 | 90,541 |
| ***Statement of income*** *(CZKm)* | | | |
| Operating income | 37,199 | 34,043 | 32,542 |
| – of which Net interest income | 22,692 | 22,235 | 22,303 |
| – of which Net fee and commission income | 6,396 | 6,218 | 6,391 |
| Operating expenses | 16,252 | 15,651 | 15,687 |
| Impairment of loans and receivables (incl. provisions) | 131 | 617 | 983 |
| Profit before tax | 20,969 | 18,380 | 16,461 |
| Profit for the year[2)] | 17,517 | 15,141 | 14,010 |
| **Ratios** *(%)* | | | |
| Return on average equity (ROAE)[3)] | 19.3 | 17.3 | 16.4 |
| Return on average assets (ROAA)[3)] | 1.26 | 1.42 | 1.49 |
| Cost / income ratio[3)] | 43.7 | 46.0 | 48.2 |
| Capital adequacy ratio[4)] | 17.2 | 18.5 | 19.4 |
| Leverage ratio[5)] | 4.48 | 5.18 | 5.25 |
| Net stable funding ratio[5)] | 146.0 | 150.9 | 134.9 |
| Loan-to-deposit ratio[3)] | 77.7 | 79.4 | 79.3 |
| Return on assets | 1.33 | 1.39 | 1.47 |
| **General Information** (as at 31 December 2017) | | | |
| Number of employees – the ČSOB group[6)] | 8,299 | 8,232 | 8,203 |
| Number of clients – the ČSOB group (in millions) | 3.686 | 3.672 | n/a |
| Number of branches – the Bank[7)] | 270 | 287 | 316 |
| Number of ATMs[8)] | 1,070 | 1,066 | 1,062 |

**ČSOB's Credit Rating**[9)] (as at 31 December 2017)

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

*1) As of 1Q 2017, ČSOB has implemented new rules of the Unified Framework of the Consolidated Financial Reporting (FINREP) issued by Committee of European Banking Supervision. This resulted in reclassification between two balance sheet lines, namely: "Cash and balances with central banks" (+) and "Loan and receivables to credit institutions - gross" (-). In order to provide fully comparable figures, years 2015 and 2016 have been restated.*
*2) Attributable to equity holders of the Bank.*
*3) As at the year end; As of 1Q 2017, calculation of Loan-to-deposit ratio has been changed, for new definition please refer to page 25. In order to provide fully comparable figures, years 2015 and 2016 have been restated.*
*4) According to CRR rules as at the year end. End of period regulatory capital (ratios) does reflect retained earnings.*
*5) According to CRR rules; for definition please refer to page 25.*
*6) Full-time equivalent employees including ICT employees which were transferred from KBC Group bank to ČSOB as of 31 December 2015. In order to provide fully comparable figures, year 2015 has been restated.*
*7) Includes ČSOB branches and Era financial centers, i.e. without approximately 2,800 post offices.*
*8) Including ATMs of cooperating banks.*
*9) Credit ratings as of the date of this Annual Report are part of the Report of the Board of Directors.*

# OPENING STATEMENT

## Ladies and gentlemen, dear colleagues,

The term "fintech" was virtually unknown ten years ago. This is no longer so. Technology has quickly found its way into almost every industry, and banking is no exception in this respect. It can be said without exaggeration that banking groups today are large technology companies. This change is not an end in itself. New technologies make people's life easier – they help our employees at work and make our services more accessible to our clients.

And people are the basic building blocks of ČSOB. With the integration of banking and insurance services, our clients will find everything they need in the area of finance in one place. And this place is no longer just a bank branch. Modern technologies allow people to manage their finances online from anywhere. Money is also assuming a new form, and mobile phones can now be used as wallets. Technologies change the way we pay for public transport tickets, park in cities or buy tickets for sports events. Of course, the development of modern technologies can never completely replace personal contact. That is why I am glad that we managed to renew our cooperation with Česká pošta (Czech Post) last year, thanks to which Poštovní spořitelna (Postal Savings Bank), in the coming years, will be within easy reach.

From the technological innovations benefit also ČSOB employees. The simplification of everyday processes also matters but, in the first place, innovations allow us to transform our working environment from the ground up. Our existing headquarters itself is already a significant advance in this respect, and the new southern building, currently under the construction, will go even further. We are trying to create an environment our people will enjoy. The southern headquarters will also open the door to enhanced labour flexibility. It is a significant investment in our people, our bank and our in-house culture. Our employees are the greatest asset we possess. Therefore I really appreciate their loyalty – half of them have been with us for eight years or more.

We are convinced that innovations are the only way forward. And I am delighted to say that our view is shared by 3.7 million ČSOB clients. We cannot disregard the excellent economic results we achieved last year. The direction we have taken is also appreciated by experts – ČSOB received the prestigious Best Bank 2017 award and a number of other industry awards.

Our success is a commitment to the society in which we operate. Through the "ČSOB Financial Education for Schools" educational programme we show people how to find their way in the world of finance. We are responding to the situations experienced by many of us and we are looking for ways to help the "sandwich generation" that finds itself literally between the millstones of care for their parents and for their children. Together with our partners, we can offer expertise in different areas of life and it is not only an advantage but also a commitment for us to use it wherever it is most needed.

I wish you a great 2018.

**John Arthur Hollows**
Chairman of the Board of Directors

# TABLE OF CONTENTS

# CZECH ECONOMY

## General Economic and Market Indicators

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

2017 was another very successful year for the Czech economy. Economic growth gradually accelerated to 5.5% in the last quarter. For the whole year, GDP growth was 4.6%, mainly due to household consumption, recovery of investment activity in the business sector, and positive export performance. The strong growth of the economy was positively reflected in the development of labour market, where unemployment declined to a historical minimum, while vacancies offered reached a new high. This positive trend was reflected in the higher willingness of households to spend and at the same time invest in the real estate market. As in the previous year, the offer of new flats was not able to respond flexibly to higher household demand, resulting in double-digit house price growth.

To a great extent, the manufacturing industry, in particular the production of passenger cars, electrical machinery and equipment, which was subsequently supported by some of the services, helped the economic growth. This was primarily retail trade, transport and finance and insurance. The construction sector recorded a slightly positive result, which, however, lagged behind the overall development of the economy and its share of value added in the economy continued to decline.

Significant changes were made during 2017 by the monetary policy of the Czech National Bank. From the beginning of the year, its intervention activities intensified considerably as the activity of foreign investors on the Czech market increased. The foreign capital inflow resulted in further increases in crown liquidity on the financial market and, in addition, negative government bond yields. Nevertheless, in April - essentially after three and a half years - the CNB withdrew the Koruna from the exchange rate regime and left its course to market development. By the end of the year, the Czech currency had appreciated by almost 6% against the Euro. Following the successful exit from the exchange rate system, the CNB subsequently increased its main interest rate to 0.50%, ending a roughly five-year period of record low interest rates in the Czech Republic.

Banking credit activity also continued to increase during 2017, while credit portfolios improved. The share of non-performing loans of households and non-financial corporations fell to just 2.5% and 4.2%, respectively. Due to the improved financial situation of households, while maintaining a relatively high level of savings, the amount of deposits in this segment of the market increased significantly in the past year, and also other attractive forms of investment offered through banks.

The strong growth of the economy was positively reflected in the state's economy. Instead of the approved deficit of CZK 60 bn, the state budget deficit reached only CZK 6.2 bn. Thus, the country's relative debt was again reduced to 32% of GDP. Total public sector indebtedness decreased to 34.6% during the course of the year, which made the Czech Republic one of the least indebted EU country.

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

| Indicator[1] | Measurement Unit | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|---|
| Nominal GDP | CZKbn | 5,055 | 4,773 | 4,596 | 4,314 | 4,098 |
| Real GDP growth | % change, Y / Y | 4.6 | 2.5 | 5.4 | 2.7 | (0.5) |
| Real GDP per capita | CZKths | 435.6 | 418.2 | 408.5 | 388.5 | 378.8 |
| Real GDP growth per capita | % change, Y / Y | 4.2 | 2.4 | 5.1 | 2.6 | (0.5) |
| Inflation rate (CPI) | %, year end | 2.4 | 2.0 | 0.1 | 0.1 | 1.4 |
| Unemployment rate | %, average | 2.9 | 4.0 | 5.1 | 6.2 | 7.0 |
| General government budget balance / Nominal GDP | % | 1.6 | 0.7 | (0.6) | (2.1) | (1.2) |
| General government debt | CZKbn | 1,749 | 1,755 | 1,836 | 1,819 | 1,840 |
| General government debt / Nominal GDP | % | 34.6 | 36.8 | 40.0 | 42.2 | 44.9 |
| Exports of goods and services[2] | % change, Y / Y | 5.5 | 2.0 | 4.3 | 13.0 | 1.7 |
| Imports of goods and services[2] | % change, Y / Y | 5.4 | (0.4) | 5.0 | 12.8 | 0.6 |
| Trade balance / Nominal GDP[2] | % | 5.0 | 5.3 | 4.1 | 5.1 | 4.1 |
| Interest rate (three month PRIBOR)[2] | %, average | 0.4 | 0.3 | 0.3 | 0.4 | 0.5 |
| CZK / EUR exchange rate[2] | average | 26.3 | 27.0 | 27.3 | 27.5 | 26.0 |

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

# REPORT OF THE BOARD OF DIRECTORS

## Highlights and Main Events

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

### The positive client experience and innovation reflected in ČSOB Group's 2017 financial results

#### Key Figures of the ČSOB Group in 2017

- **Number of ČSOB group clients rose by 14 thousand.**
- **ČSOB group net profit increased by 16% Y/Y to CZK 17.5 bn.**
- **Loan portfolio** (including ČMSS) **grew to CZK 657 bn** (+6% Y/Y).
- **Group deposits** (including ČMSS) **moved up to CZK 821 bn** (+9% Y/Y).
- **Total volume of assets under management expanded to CZK 202 bn** (+6% Y/Y).
- **Operating income increased to CZK 37.2 bn** (+9% Y/Y).
- **Operating expenses rose to CZK 16.3 bn** (+4% Y/Y).

The ČSOB group closely manages credit risk and maintains strong capital and liquidity positions as reflected in the following 2017 year-end figures:

- **Credit cost ratio** in 2017 decreased year on year to **2 bps** and **NPL ratio** decreased to **2.33%** thanks to excellent loan quality.
- The **loan-to-deposit ratio** decreased year on year to **77.7%** and **net stable funding ratio** (NSFR) reached **146.0%**.
- **Tier 1 ratio** stood at **17.2%**.

#### Partnership agreement with Czech Post

**ČSOB and Česká pošta** (Czech Post) have prolonged and intensified mutual cooperation by **signing a 10-year exclusivity partnership** agreement. **ČSOB has become Česká pošta's sole partner in providing banking and insurance services** as of 1 January 2018. The new strategic partnership with Czech Post is extending a quarter of a century of mutual collaboration and allows ČSOB to significantly expand the offer of banking and insurance products, jointly develop the network of specialised post office counters but also achieve important synergies.

#### IFRS 9

**IFRS 9 Financial Instruments** is effective for periods beginning on or after 1 January 2018. The first time application of IFRS 9 led to a drop of the Group's total capital ratio by 5 basis points. A combined negative effect of reclassification of the part of the Treasury bond portfolio and an initial ECL recognition was compensated by reduction of IRB shortfall. ČSOB is thus compliant with the IFRS 9 standard.

*For more details please refer to the Separate Financial Statements for the year 2017 (Note 2.3) and to the Consolidated Financial Statements for the year 2017 (Note 2.3).*

#### Dividends paid

Based on a sole shareholder decision from 27 April 2017, a dividend of CZK 34.66 per share was paid for 2016, representing a total dividend of CZK 10,147 m. The decision of a profit allocation for 2017 has not been taken before the date of issue of the annual report.

*For more details please refer to the Separate Financial Statements for the year 2017 (Note 13) and to the Consolidated Financial Statements for the year 2017 (Note 15).*

### Changes to scope of consolidation and business combinations

On 17 May 2017, the management of the Bank decided to merge the Bank with its subsidiaries Centrum Radlická and Patria Online, ČSOB being the successor company, resulting in the simplification of the consolidation scope of the Group.

*For more details please refer to the Separate Financial Statements for the year 2017 (Note 18) and to the Consolidated Financial Statements for the year 2017 (Note 3).*

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

- Petr Šobotnik was elected a member of ČSOB's Supervisory Board with effect from 1 February 2017.
- Marcela Suchánková was elected a member of ČSOB's Board of Directors with effect from 1 March 2017.
- Jan Sadil was elected a member of ČSOB's Board of Directors with effect from 1 March 2017.
- Tomáš Kořínek was removed from ČSOB's Board of Directors with effect from 28 February 2018.
- Hélène Goessaert was elected a member of ČSOB's Board of Directors with effect from 1 March 2018.

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

## Innovation Leadership in 2017

In 2017, ČSOB has been building up digital capabilities and investing in technology.

- Clients can use **fingerprint sign-in**, supported by all ČSOB mobile applications.
- **Internet Banking** for retail clients brings new features such as **personal finance management** and an overview of **all client's products including insurance at one place.**
- **More than 40% of all documents have been digitally-signed** at branches in 2017.
- New electronic banking platform for corporate and SME clients brings **simplified and intuitive interaction with the bank.**
- Clients enjoy **new features** in the mobile wallet **"ČSOB NaNákupy"**, such as transaction history, MasterPass internet payments and management of loyalty cards.
- Clients can take advantage of **comprehensive online mortgage overview** with all related documents.
- New mobile application "Patria MobileTrader" **allows clients to trade with investment products anytime and anywhere**.
- Clients can **report insurance claims online**: simple and intuitive process allows clients to track also its settlement.
- **Bonuses for all retail clients** with the loyalty program "Svět odměn" also in the new Internet Banking.
- One-stop shop digital environment **"ČSOB Investice"**, where clients manage their investments, was improved by the inclusion of **Patria** products.
- More than **three hundred contactless ATMs** enable clients to withdraw cash comfortably and securely without risk of magnetic card skimming.

# Awards

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

- ČSOB received the **Best Bank**, the **Best life insurance company** (ČSOB Pojišťovna) and thanks to the application NaNákupy the **Bank Innovator** awards for 2017 by Czech business daily Hospodářské noviny.
- For philanthropic activities over the last 20 years, the public voted ČSOB as **the winner of The Via Bona Good Company award**.
- ČSOB was named **the Best Bank** of 2018 in the Czech Republic by Global Finance magazine.
- The Banker magazine selected ČSOB as **the Best Bank** in the Czech Republic in 2017.
- ČSOB voted as **the Best Bank** by magazine EMEA Finance.
- The magazine Euromoney awarded ČSOB Private Banking for the year 2018 as **the Best Private Bank** in the Czech Republic for the fifth time in a row.
- International Banker magazine voted ČSOB Private Banking as **the Best Private Bank** in the Czech Republic in 2017.

## Other Awards

- Hypoteční banka was awarded The Mortgage of the Year in Fincentrum Bank of the Year 2017 award and ČSOB was awarded The Bank without Barriers (1st place).
- In Sodexo Employer of the year 2017 award ČSOB was selected the third best employer above 5,000 employees in the Czech Republic (overall ranking regardless of industry).
- In the TOP Responsible Company 2017 award, ČSOB received Gold certificate in the Top Responsible Large Company category, Gold certificate in the Diversity Strategy category, Gold certificate in the Responsible Reporting category, Silver certificate in the Community Project for Public Benefit category.
- ČSOB Asset Management won the 2017 European Structured Products & Derivatives Awards in the category of the Best Distributor in the Czech Republic.
- ČSOB was named the Best FX Provider in the Czech Republic for 2017 by Global Finance magazine.
- ČSOB awarded the Best provider of the financial services for international trade in the Czech Republic in the Global Finance Magazine Award.

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

# The Board of Directors' Assessment of 2017 and Expectations for 2018

Supported by improved market opportunities, the ČSOB group delivered a very strong performance on the stable Czech banking market. Even though the operating environment remained benign, margin erosion and pressure from regulations have not abated.

The banking sector remained generally stable, well-capitalized, liquid and profitable. Its resilience was confirmed by results of stress tests conducted by the Czech National Bank. Growth in bank loans, especially to households for house purchase and consumption, remained strong in 2017.

The sector performance was supported by the recovery of the Czech economy, as the Czech Republic has become one of the fastest growing countries in the EU. After 2016 deceleration, economic growth gathered momentum in 2017 and reflected positively in employment levels and rising wages that push household consumption. The economy has ceased to need the stimulus in the form of a weak currency and after about three and a half years, the Czech National Bank could release it from the exchange rate commitment, which not only supported GDP growth and inflation but also strengthened the foreign exchange reserves of the central bank.

To tackle the rising inflation, monetary policy has been tightened. Czech central bank has raised interest rates for the first time since the financial crisis, becoming the first in the EU to start a gradual exit from a period of low interest rates. Nevertheless interest rate margins, weakened by the long period of low interest rates, continued to erode. Banks continued to benefit from access to customer deposits and ample liquidity on the market.

Czech banking landscape continued to be affected by the effects of previously introduced legislations and changes of regulatory environment. In 2017, the Czech National Bank has continued with and tightened macro-prudential measures to slow the growth in mortgage lending. Countercyclical capital buffer (CCyB) set at 0.5% entered into the minimum capitalization required by the Czech central bank from July 2017.

In 2017, the ČSOB group further expanded the bank-insurance model and continued to bring simple, transparent and user-friendly solutions in order to meet clients' expectations towards financial services providers. ČSOB and Česká pošta (Czech Post) proceeded to extend mutual cooperation and signed a 10-year exclusivity partnership agreement whereby ČSOB becomes Česká pošta's sole partner in providing banking and insurance services.

ČSOB delivered strong performance in 2017. Net profit increased by 16% as a result of the generally positive situation on financial markets, higher revenues from assets and liabilities management, increased revenue from investment products and foreign payment fees and commissions, and one-off income on the back of the successful conclusion of a historical legal dispute. Also supporting this result was lower costs of risk and strong growth in mortgages, SME and consumer loans as well as increased volumes of assets under management. The credit quality of the loan portfolio continued to improve, with the non-performing loans ratio recording yet a new all-time low of 2.33%.

According to the ČSOB group's macroeconomic outlook, the GDP for the year 2018 is expected slow-down, nevertheless will maintain a solid growth of about 3%. Inflationary pressures will require a less relaxed monetary policy and hence a rise in interest rates. The Board of Directors considers that moderate economic growth and low unemployment levels will sustain credit demand, as well as support loan quality, even though partial normalization of low levels of credit costs is conceivable. ČSOB will continue to benefit from good access to customer deposits to fund lending.

For 2018 and beyond, banks must deal with multiple challenges tied to regulatory environment, such as: the directive and regulation on markets in financial instruments ("MiFID 2" and "MiFIR"), new Payment System Act, which implements the EU directive "PSD 2", the General Data Protection Regulation ("GDPR") and the announced increases in the countercyclical capital buffer (CCyB).

Servicing retail clients continues to be core to the business of the ČSOB group also in 2018. ČSOB will focus on even greater intensity and effectiveness of cooperation with the Czech Post. The ČSOB group will continue accommodating the needs of its SME and corporate clients.

The ČSOB group will further endeavor to maintain solid profitability via business volumes growth and efficient cost control while sticking to its focus on asset quality. To cope with the challenges ahead, ČSOB will focus on bringing its clients simple and smart solution. ČSOB will further invest in the innovation of products and services needed for the sustainability and competitiveness of its business. To achieve this, ČSOB group will continue working in the background on more effective operations and manage costs carefully.

## Strategy of the ČSOB Group and its Business Model

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

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

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

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

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

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

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

# Financial Results

*All financial figures hereinafter were drawn from ČSOB's 2017 audited, consolidated financial statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU IFRS), unless otherwise stated.*

## Financial Ratios

| | 2017 (%) | 2016 (%) | Y/Y change (pp) |
|---|---|---|---|
| Return on average equity (ROAE) | 19.3 | 17.3 | 2.0 |
| Return on average assets (ROAA) | 1.26 | 1.42 | (0.16) |
| Net interest margin | 2.98 | 2.93 | 0.05 |
| Cost / income ratio | 43.7 | 46.0 | (2.3) |
| Credit cost ratio | 0.02 | 0.11 | (0.09) |

| | 31. 12. 2017 (%) | 31. 12. 2016 (%) | Y/Y change (pp) |
|---|---|---|---|
| Loan-to-deposit ratio | 77.7 | 79.4 | (1.7) |
| Capital adequacy ratio* | 17.2 | 18.5 | (1.3) |
| Leverage ratio* | 4.48 | 5.18 | (0.70) |
| Net stable funding ratio* | 146.0 | 150.9 | (4.9) |

** Calculation is based on CRR rules.* *Note: pp = percentage point.*

*Calculation of loan-to-deposit ratio has been changed. In order to provide fully comparable figures, loan-to-deposit ratio has been restated retrospectively.*

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

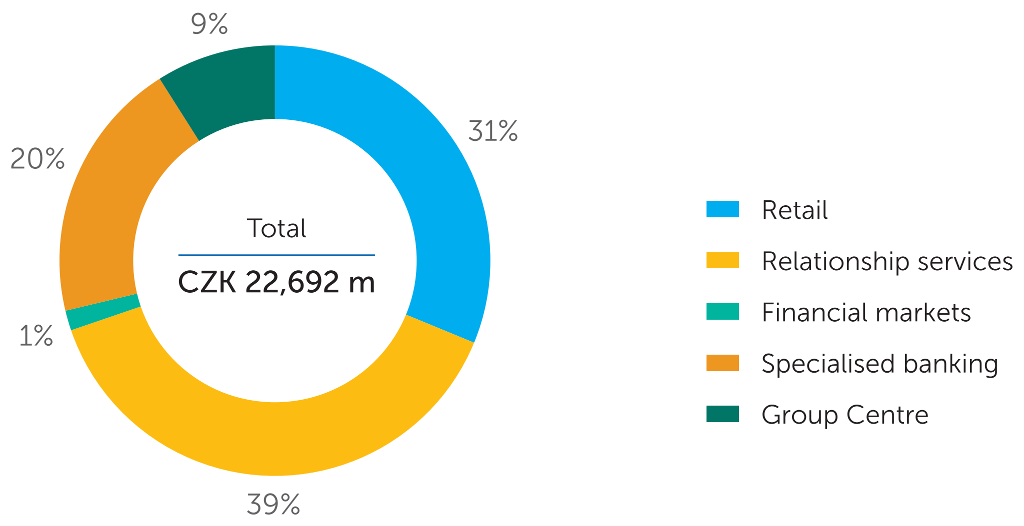
# Consolidated Statement of Income

| (CZKm) | 2017 | 2016 | Y/Y change (%) |
|---|---|---|---|
| Interest income | 25,979 | 25,043 | 3.7 |
| Interest expense | (3,287) | (2,808) | 17.1 |
| **Net interest income** | **22,692** | **22,235** | **2.1** |
| Fee and commission income | 10,126 | 9,577 | 5.7 |
| Fee and commission expense | (3,730) | (3,359) | 11.0 |
| **Net fee and commission income** | **6,396** | **6,218** | **2.9** |
| Dividend income | 11 | 8 | 37.5 |
| Net gains from financial instruments at fair value through profit or loss | 5,825 | 3,147 | 85.1 |
| Net realised gains on available-for-sale financial assets | 455 | 1,294 | (64.8) |
| Income from operating lease | 2,063 | 1,757 | 17.4 |
| Expense from operating lease | (1,709) | (1,452) | 17.7 |
| Other net income | 1,466 | 836 | 75.4 |
| **Operating income** | **37,199** | **34,043** | **9.3** |
| Staff expenses | (7,920) | (7,510) | 5.5 |
| General administrative expenses | (6,952) | (6,873) | 1.1 |
| Depreciation and amortization | (1,380) | (1,268) | 8.8 |
| **Operating expenses** | **(16,252)** | **(15,651)** | **3.8** |
| Impairment losses | (615) | (708) | (13.1) |
| *of which Impairment on loans and receivables (including provisions)* | (131) | (617) | (78.8) |
| Share of profit of associates | 637 | 696 | (8.5) |
| **Profit before tax** | **20,969** | **18,380** | **14.1** |
| Income tax expense | (3,453) | (3,232) | 6.8 |
| **Profit for the year** | **17,516** | **15,148** | **15.6** |
| Attributable to: | | | |
| Owners of the parent | 17,517 | 15,141 | 15.7 |
| Non-controlling interests | (1) | 7 | n/a |

## Discussion of the Statement of Income Main Items

With a 61% share, the **net interest income** (NII) is the largest part of the operating income. The ČSOB group's NII increased year on year (+2.1%) driven by other NII (thanks to ALM income), while NII from loans (especially mortgages) and deposits decreased. The **net interest margin** (NIM) slightly increased to 2.98% in 2017 from 2.93% in 2016, thanks to ALM contribution and active management of funding costs, offset by lower reinvestment yields and ongoing pressure on lending margins.

### Net interest income by reported segments




Out of the reporting segments, the highest contribution came from Relationship services which represents 39% of consolidated NII; the NII in this segment increased by 4.3% year on year driven by growth in business volumes. The Retail segment, making up 31% of the consolidated NII, decreased by 3.4% year on year due to declining margins. The NII of the Specialised banking segment, which represents 20% of consolidated NII, decreased by 7.1% year on year also due to declining margins. The Group Centre represents 9% of the consolidated NII and increased by 19.7% year on year thanks to ALM income. The Financial markets segment makes 1% of the consolidated NII and increased to CZK 341m, from a negative NII year earlier thanks to positive situation on financial markets.

The **net fee and commission income** (NFCI) represented 17% of operating income. In 2017, NFCI increased by 2.9% year on year on the back of increased revenue from investment products, foreign payments, loans, payment card fees, while the fees from domestic payments and account fees decreased.

**Net gains from financial instruments at fair value through profit or loss** represented 16% of operating income and increased by 85.1% year on year driven by strong performance of financial markets.

**Net realised gains on available-for-sale financial assets** represented 1% of operating income and decreased by 64.8% year on year driven by one-off gain from VISA Europe sale (CZK 1,295 m) booked in 2016.

**Other net income and income and expenses from operating leases** combined represented 5% of operating income and increased by 59.5% year on year mainly thanks to one-off gain from historical legal case.

**Staff expenses** represented 49% of the ČSOB group's operating expenses in 2017. Staff expenses increased by 5.5% year on year as a result of wage adjustments and higher variable remuneration, extra bonuses for employees, higher average number of FTEs and lower base in 2016 (higher share of IT projects with capitalized staff expenses).

**General administrative expenses** (GAE) contributed 43% to the ČSOB group's operating expenses in 2017.

ICT related expenses increased by 6.0% year on year and remained the largest part of GAE (34%). Building-related expenses decreased (15% of GAE; -1.8% year on year). Banking taxes, including deposit insurance premium, Securities Traders Guarantee Fund and contribution to the Crisis

Resolution Fund (or the Single Resolution Mechanism) decreased (10% of GAE; -5.1% year on year). Marketing expenses increased (10% of GAE; +2.5% 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 by 13.1% year on year as a result of a decline in impairments on loans and receivables (by 78.8%; including provisions), while impairments on other assets combined increased (by over 100%).

As a result of the trends described above, the **net profit for 2017 attributable to owners of the parent equaled CZK 17,517 m**, i.e. 15.7% higher than the figure for 2016.

*More details are available in the Consolidated Financial Statements for the year 2017: Net interest income (Notes 5 and 6), Net fee and commission income (Note 7), Net gains from financial instruments at fair value through profit or loss (Note 8), Net result from operating lease (Note 9), Other net income (Note 10), Staff expenses (Note 11), General administrative expenses (Note 12) and Impairment losses (Note 13).*

## Consolidated Statement of Financial Position

*(Excerpt)*

| (CZKm) | 2017 | 2016 | Y/Y change (%) |
|---|---|---|---|
| Financial assets held for trading (including pledged as collateral) | 18,342 | 20,008 | (8.3) |
| Available-for-sale financial assets (including pledged as collateral) | 35,329 | 56,938 | (38.0) |
| Held-to-maturity investments (including pledged as collateral) | 115,621 | 132,679 | (12.9) |
| Loans and receivables | 1,062,201 | 782,099 | 35.8 |
| **Total assets** | **1,315,590** | **1,085,527** | **21.2** |
| Financial liabilities held for trading | 34,606 | 40,044 | (13.6) |
| Deposits at amortised cost received from other than credit institutions | 744,448 | 676,162 | 10.1 |
| Debt securities in issue | 350,136 | 222,997 | 57.0 |
| **Total liabilities** | **1,221,887** | **996,792** | **22.6** |
| Total equity | 93,703 | 88,735 | 5.6 |
| **Total liabilities and equity** | **1,315,590** | **1,085,527** | **21.2** |

### Discussion of the Statement of Financial Position Items

Total consolidated assets of ČSOB group increased by 21.2% year on year. Loans and receivables, the largest item thereof with 81% share, increased by 35.8% year on year (driven by reverse repo operations with Czech National Bank, loans to private individuals and loans to Other legal entities). Loans and receivables are discussed in detail in the Business Results section below.

The development of securities portfolios (13% of total assets in aggregate) in 2017:

- Financial assets held for trading (1% of total assets) declined by 8.3% year on year.
- Held-to-maturity investments (HTM; 9% of total assets) went down by 12.9% year on year.
- Available-for-sale financial assets (AFS; 3% of total assets) decreased by 38.0% year on year.

*Further discussion of the portfolios can found in the Consolidated Financial Statements for the year 2017, including the breakdown of exposure per type of borrower (Notes 17 and 18) or per country (Note 40).*

No treasury shares were held by the ČSOB group at 31 December 2016 and 2017.

# Regulatory Capital Adequacy

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

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

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

| (CZKm, unless indicated otherwise) | 2017 | 2016 | Y/Y change (%) |
|---|---|---|---|
| CET1 capital before regulatory adjustments | 77,391 | 78,404 | (1.3) |
| Regulatory adjustments of CET1 capital | (8,293) | (9,423) | (12.0) |
| Tier 1 capital = Core Tier 1 capital | 69,098 | 68,981 | 0.2 |
| Tier 2 capital | 0 | 1,311 | (100.0) |
| **Total regulatory capital** | **69,098** | **70,292** | **(1.7)** |
| Risk weighted assets on credit and settlement risk | 313,037 | 308,743 | 1.4 |
| Risk weighted assets on market risk | 32,369 | 14,072 | 130.0 |
| Risk weighted assets on operational risk | 56,872 | 56,156 | 1.3 |
| **Total Risk weighted assets** | **402,278** | **378,970** | **6.2** |
| Tier 1 ratio = Core Tier 1 ratio (in %) | 17.2 | 18.2 | (1.0 pp) |
| Capital adequacy ratio (in %) | 17.2 | 18.5 | (1.3 pp) |

*Calculation is based on CRR rules.*

*End of period regulatory capital (and the respective ratios) reflects retained earnings. More details are available in the Consolidated Financial Statements for the year 2017 (Note 41).*

*Note: pp = percentage point.*

# Credit Rating

*Events related to ČSOB's credit ratings between 1 January 2017 and the date of this Annual Report.*

### In 2017, ČSOB was using the service of the following rating agencies:

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

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

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

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

### Rating of ČSOB in 2017 and 2018

#### S&P agency

- On 17 March 2017, S&P affirmed ČSOB's long-term credit rating at A with stable outlook. The rating action followed upgrade of Czech banking sector to BICRA (Banking Industry Country Risk Assessment) group 3 from group 4.
- On 27 October 2017, S&P revised from stable to positive its outlooks on ČSOB. Long-term credit rating was affirmed at A.
- On 21 December 2017, S&P affirmed its long-term credit rating at A (Positive).

#### Moody's agency

- At year-end 2017, the long-term rating assigned to ČSOB by Moody's was A2 with stable outlook.

# Business Results

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

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

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

1. The growth of the Czech economy is expanding the short term opportunities of the banking sector and at the same time contributing to improving its quantitative as well as qualitative characteristics:
   - The continued solid growth of the economy may again have a positive impact on the ČSOB group.
   - Decreasing unemployment can contribute to reducing credit risks, thus positively affecting the ČSOB group.
   - The growth of exports and imports could also have a positive impact on the ČSOB group.
2. The **interest rate** environment has an impact on the ČSOB group's business, particularly on the ČSOB group's net interest income and the net interest margin.
3. With the change of **credit quality** of loans and receivables, both on-balance sheet and off-balance sheet, required provisioning ratios may be altered if the recovery ratio or the value of available collateral is also impacted.
4. Significant amounts held in **securities portfolio** may have to be revalued as a result of relevant changes in e.g. liquidity, volatility, pricing information, business climate, credit rating changes, regulatory actions or unanticipated changes in the competitive environment. ČSOB prefers to purchase bonds issued by government institutions, which account for majority of all bonds.
5. **Competition:** The EU legislation allows banks from other EU member states to easily enter the Czech banking market, thus possibly intensify the competitive environment.

## ČSOB Group Market Position

| Position | Segment | Market share | Y/Y change |
|---|---|---|---|
| 1st | **Total Loans**[1] | **19.9%** | ↑ |
| | Building savings loans[1] | 44.0% | ↓ |
| | Building savings deposits[1] | 39.6% | ↑ |
| | Mortgages[1] | 28.5% | ↑ |
| | Leasing[1] | 18.5% | ↓ |
| 2nd | **Total Deposits**[1] | **20.0%** | ↑ |
| | Mutuals funds[1] | 22.1% | ↓ |
| | Factoring[2] | 24.1% | ↓ |
| 3rd | Pension funds[3] | 14.2% | → |
| | SME/corporate loans[1] | 15.2% | → |
| | Consumer lending[1, 4] | 11.4% | ↑ |
| 4th | **Insurance[5] – combined** | **7.5%** | ↑ |
| | Non-life insurance[5] | 7.3% | ↑ |
| | Life insurance[5] | 7.8% | ↑ |

***Market shares as of 31 December 2017.***

*Arrows show Y/Y change. The ranking is ČSOB's estimate. Market position in the insurance reflects combined position of the insurers belonging to the same business group.*

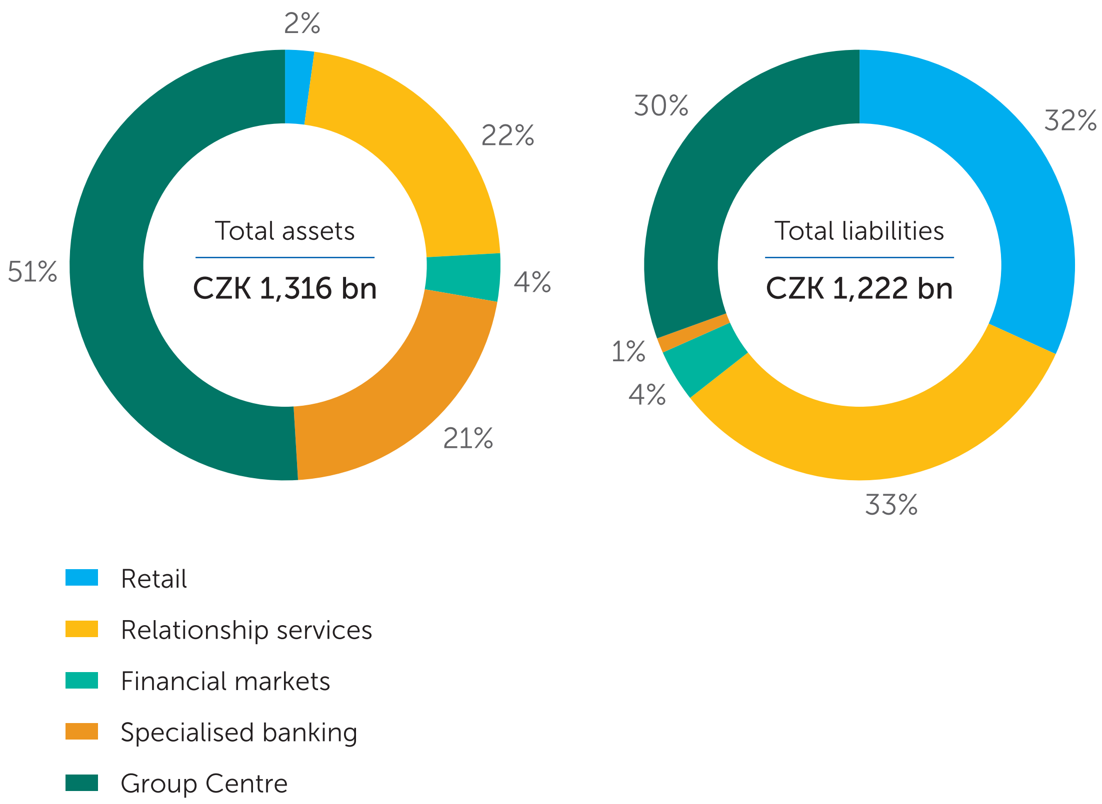
*1) Outstanding at the given date (including ČMSS);*
*2) New business in the year to the given date;*
*3) Number of total clients at the given date;*
*4) Retail loans excluding mortgages and building savings loans.*
*5) New business in the year according to gross written premium.*

## Segment View

ČSOB group has **five segments**, which are the group's strategic business units: **Retail**, **Relationship services**, **Financial markets**, **Specialised banking** and **Group Centre**. The strategic business units offer different products and services, and are managed separately based on the Group's management and internal reporting (controlling) structure.

In 2017, the Group's segment reporting was modified following the change of the organisational structure of the Group. Thus, Asset Management and Penzijní společnost (Pension Company) are managed in the same way as retail clients and were moved from strategic business unit Specialised banking to Retail in 2017.

### Total assets and liabilities by reported segments




## Retail

### The ČSOB Retail segment represented 2% of ČSOB's assets and 32% of ČSOB's liabilities as at the 31 December 2017.

Retail clients comprise private individuals and entrepreneurs, except of private banking customers that are reported as a part of Relationship services. This segment contains customers' deposits, consumer loans, overdrafts, payment solutions including payment cards, pension funds, mutual funds and asset management and other transactions and balances with retail customers.

As at 31 December 2017, the ČSOB group had approximately 3.5 million group retail clients in the Czech Republic.

Retail clients benefit from ČSOB's **wide sales network** of 217 predominantly shared retail / SME branches, 31 Era Financial Centers / PSB branches and approximately 2,800 outlets of the Czech Post network and additional 400 Czech Post franchise outlets. Clients can also use a wide network of 1,070 ATMs, including 302 contactless and 170 deposit ATMs.

### Most Notable Events and Trends

- ČSOB and Česká pošta (Czech Post) have signed a 10-year exclusivity partnership agreement whereby **ČSOB has become Česká pošta's sole partner in providing banking and insurance services.**
- **Consumer finance lending exhibited strong dynamics in 2017.** Outstanding volumes increased by 16.0% year on year thanks to improved attractiveness of product offer (pricing, conditions, processing) for both existing and new clients. The increase was fully driven by cash loans, while credit cards and overdrafts decreased year on year.
- The **market share in consumer lending increased** year on year to 11.4% and ČSOB maintained the third position on the market of consumer lending.
- **Client deposits increased** driven by current accounts.
- **Number of transactions with cards issued by ČSOB increased** by 17.7% year on year, of which number of transactions at merchants increased by 22.9%. Volume of transactions increased by 9.6%, of which volume of transactions at merchants increased by 20.1%.
- The number of dedicated **insurance advisors at the bank branches increased** to 156 at the end of the year 2017.
- The volume of **pension funds increased** by 9.0% year on year driven mainly by increase of new sales and higher contribution of existing clients.
- **Mutual funds and other AM increased** by 4.8% year on year, thanks to growth in all categories. Mutual funds increased by 5.2% year on year driven by both higher net sales as well as a positive market performance effect.

| Retail: Key Volumes (CZKm) | 2017 | 2016 | Y/Y change (%) |
|---|---|---|---|
| Credit portfolio – consumer loans | 28,061 | 24,183 | 16.0 |
| – of which credit cards and overdrafts | 2,886 | 2,921 | (1.2) |
| – of which cash loans | 23,139 | 19,271 | 20.1 |
| | | | |
| Mutual funds and other AM (Outstanding volume, CZKm) | 152,498 | 145,548 | 4.8 |
| – of which structural/capital protected funds | 21,702 | 20,598 | 5.4 |
| – of which other mutual funds | 67,481 | 64,161 | 5.2 |
| – of which other management assets | 55,928 | 53,754 | 4.0 |

# Relationship Services

**The ČSOB Relationship services segment comprised 22% of assets and 33% of liabilities of the ČSOB group as at the 31 December 2017.**

The Relationship services segment includes corporate companies with a turnover of greater than CZK 300 m, SME companies with a turnover of less than CZK 300 m, private banking customers with financial assets above CZK 10 m, financial and public sector institutions. This segment contains customers' deposits, loans, overdrafts, payment solutions including payment cards, leasing and other transactions and balances with corporate, SME customers and private banking customers.

As at 31 December 2017, the ČSOB group had approximately 4,500 corporate, 133,000 SME and 7,200 private banking clients in the Czech Republic.

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

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

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

## Most Notable Events and Trends

- **The volume of the corporate credit portfolio reached CZK 150.6 bn** at the end of 2017 (up 1.0% year on year) and has grown continuously since late 2010. The major year on year loan growth was recorded in sectors: distribution, media and electricity.
- **SME volumes increased** by 4.8% year on year thanks to an expansion in core SME lending (micro, small and mid-sized companies).
- ČSOB group's **market share** of SME / corporate loans **stood at 15.2%** at the end of the year 2017.
- **ČSOB Leasing** kept its market leading position. **Outstanding volumes increased** by 10.9%. The primary drivers were machinery & equipment financing mainly in the corporate and SME segments and car loans.

| Relationship Services: Key Volumes (CZKm) | 2017 | 2016 | Y/Y change (%) |
|---|---|---|---|
| Credit portfolio – corporate | 150,574 | 149,098 | 1.0 |
| Credit portfolio – SME | 86,224 | 82,271 | 4.8 |
| Credit portfolio – factoring | 6,661 | 5,563 | 19.8 |
| Credit portfolio – leasing | 40,161 | 36,202 | 10.9 |

## Financial Markets

### The ČSOB Financial markets segment represented 4% of ČSOB group's assets and 4% of its liabilities as at the 31 December 2017.

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

## Specialised Banking

### The ČSOB Specialised banking segment represented 21% of ČSOB group's assets and 1% of its liabilities as at 31 December 2017.

The Specialised Banking segment contains mortgages, building savings and building savings loans.

### Most Notable Events and Trends

- In 2017, **ČSOB expanded outstanding mortgage volumes** by 10.0% year on year as the demand was supported by prevailing low interest rates and real estate prices. ČSOB provided almost **30 thousand new mortgages** (-4.8% year on year) in the total amount of **CZK 63 bn** (-1.8% year on year), both in line with the year on year market development. Mortgages provided via various distribution channels are booked in Hypoteční banka. In 2017, the average size of new mortgage loan was CZK 2.1 m and the interest rate was on averaged fixed for over 5 years.
- Outstanding **building savings loan portfolio declined** by 1.4% year on year and new sales declined as well, mainly due to overall tightening of regulatory measures. ČMSS maintained its market leading position in 2017.

| Specialised Banking: Key Volumes (CZKm) | 2017 | 2016 | Y/Y change (%) |
|---|---|---|---|
| Credit portfolio – mortgages | 282,380 | 256,690 | 10.0 |
| Credit portfolio – building savings loans (55%) | 63,420 | 64,310 | (1.4) |

## Group Center

### The Group Center comprised 51% of ČSOB group's assets and 30% of its liabilities as at 31 December 2017.

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

# Insurance

**As at 31 December 2017, ČSOB Pojišťovna reached a 7.8% market share in life gross written premium and a 7.3% market share in non-life gross written premium** (according to the Czech Insurance Association's methodology).

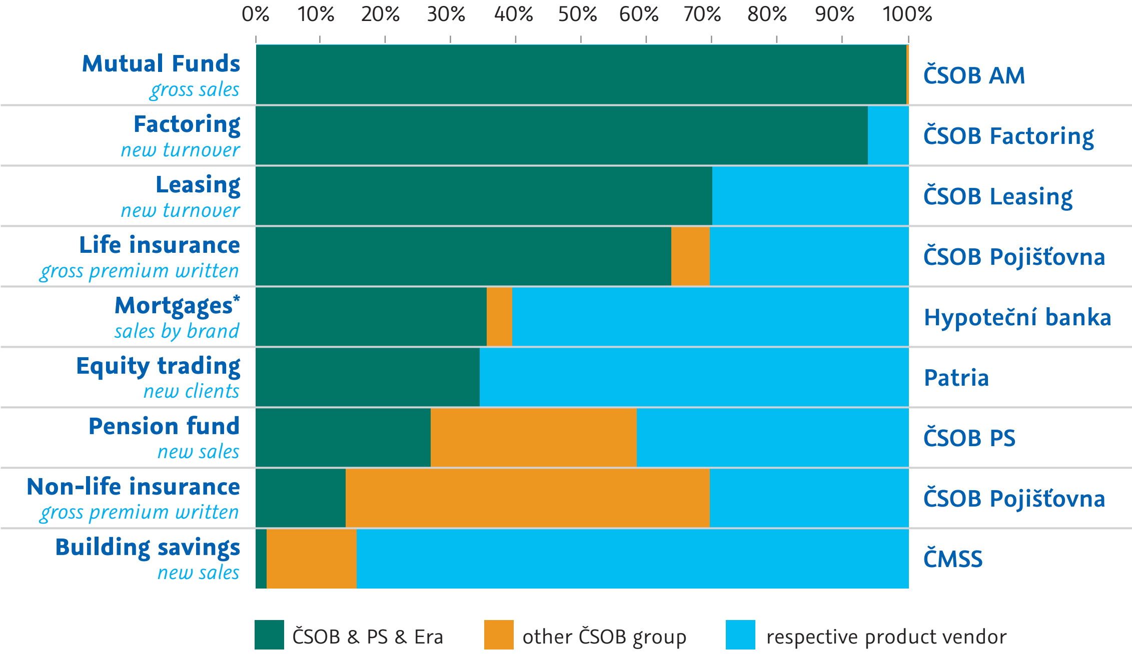
ČSOB Pojišťovna provides its clients with a wide range of insurance products, including single and regular premium life insurance as well as car (for individuals and corporate clients), house, accident, travel and industrial insurance. As at 31 December 2017, ČSOB Pojišťovna had over 1.184 million clients, comprising of individuals and business entities (including SME's as well as corporates). Insurance products are mainly distributed through the internal agent network, ČSOB group's branches and external brokers.

| Insurance: Key Volumes (CZKm) | 2017 | 2016 | Y/Y change (%) |
|---|---|---|---|
| Single life insurance | 3,829 | 4,571 | (16.2) |
| Regular life insurance | 3,023 | 2,747 | 10.0 |
| **Life insurance total** | **6,852** | **7,318** | **(6.4)** |
| **Non-life insurance total** | **5,922** | **5,275** | **12.3** |
| **Total** | **12,774** | **12,593** | **1.4** |
| Amount of benefits paid to clients | 7,055 | 7,920 | (10.9) |
| Number of cases settled | 215,341 | 219,359 | (1.8) |

# ČSOB Group Synergies

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

## New Production in 2017 – Shares of Distribution Channels per Product Type




*The chart shows the volumes distributed in 2017 by the companies of the ČSOB group.*

*Distribution by third parties is included in the figures for the respective product vendors.*

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

## Definitions and Glossary of Financial Ratios

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

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

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

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

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

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

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

***Loan-to-deposit ratio*** *represents loans and receivables to other than credit institutions (net) / Deposits received from other then credit institutions at amortised cost minus repo operations with non-banking financial institutions.*

***Net interest margin*** *is net interest income / average interest earnings assets excluding repo operations.*

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

***ROAA*** *is net profit for the year / average of total assets.*

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

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

# ABOUT US

## Company Profile

### From ČSOB's History

**1964** ČSOB established by the state as a bank to provide foreign trade financing and convertible currency operations in the then Czechoslovak market.

**1993** Continuation of ČSOB's activities in both the Czech and Slovak market after the split of Czechoslovakia.

**1999** ČSOB privatized – Belgium-based KBC Bank becoming the majority shareholder of ČSOB.

**2000** Acquisition of Investiční a Poštovní banka (IPB).

**2007** KBC Bank becoming ČSOB's sole shareholder after buying out all minority shareholders. New environmentally friendly building of ČSOB's headquarters in Prague – Radlice (Building of the Year 2007).

**2008** As at 1 January, ČSOB's Slovak branch separated into a separate entity, fully controlled by KBC Bank via 100% of voting rights.

**2009** In December, ČSOB sold its remaining interest in the Slovak activities to KBC Bank.

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

**2017** New 10-year (for period 2018-2027) exclusivity partnership agreement for both banking and insurance services signed with Česká pošta (Czech Post).

### ČSOB and ČSOB Group Profile

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

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

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

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

With total assets of CZK 1,315.6 bn as at 31 December 2017 and a total net profit of CZK 17.5 bn in 2017 **the ČSOB group is one of the top three banking groups in the Czech Republic**. As at 31 December 2017, the ČSOB group had CZK 821 bn of group deposits (including ČMSS) and a loan portfolio of CZK 657 bn (including ČMSS).

# ČSOB Group in Figures

| | 31. 12. 2017 | 31. 12. 2016 |
|---|---|---|
| **ČSOB branches (bank only)** | **270** | **287** |
| ČSOB Retail/SME branches incl. dual branded (ČSOB + PSB/Era) | 217 | 216 |
| PSB/Era Financial Centers | 31 | 49 |
| ČSOB Private Banking branches | 11 | 11 |
| ČSOB Corporate branches | 11 | 11 |
| | | |
| **ČSOB Pojišťovna branches** | **97** | **92** |
| **Hypoteční banka centers** | **30** | **29** |
| **ČMSS advisory centers** | **302** | **308** |
| **Leasing branches** | **7** | **10** |
| **PSB outlets of the Czech Post network** | **ca 2,800** | **ca 3,000** |
| – of which specialized banking counters | 152 | 150 |
| | | |
| **ATMs**[1)] | **1,070** | **1,066** |
| – of which contactless | 302 | 80 |
| | | |
| **ČSOB Group's clients** (mil.) | **3.686** | **3.672** |
| **Internet Banking** – users (mil.) | **1.626** | **1.566** |
| – transactions (mil.) | **54.712** | **51.694** |

*1) Including ATMs of cooperating banks.*

| Employees (*FTEs*) | 31. 12. 2017 | 31. 12. 2016 |
|---|---|---|
| Employees of the ČSOB group (FTEs)[2)] | 8,299 | 8,232 |
| of which the Bank | 7,150 | 7,071 |

*2) Excluding employees of the joint venture and associated companies.*

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

# KBC Group Profile

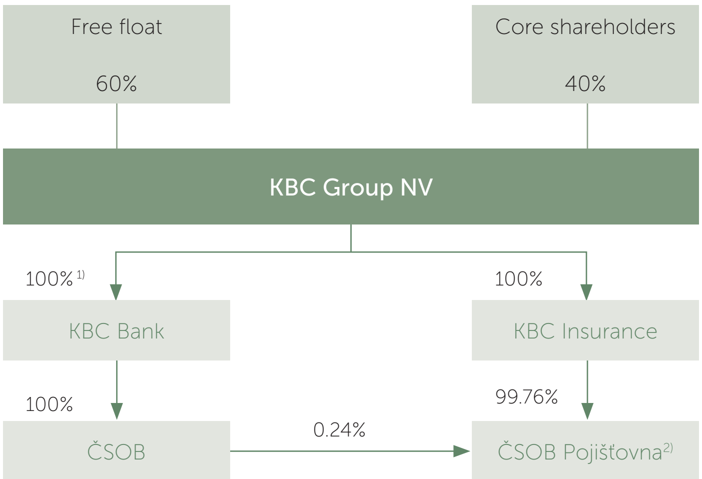
ČSOB is a wholly-owned subsidiary of KBC Bank NV, whose shares are held (directly or indirectly) by KBC Group NV. KBC Bank and KBC Group are both based in Brussels, Belgium.

KBC is an integrated bank-insurance group, catering mainly for retail, private banking, SME and mid-cap clients. Geographically, KBC focuses on its home markets of Belgium, the Czech Republic, Slovakia, Hungary, Bulgaria and Ireland. Elsewhere in the world, KBC is present in several other countries to support corporate clients from its core markets. As of the end of 2017, the KBC Group served 11 million clients in its home markets, and employed approximately 42,000 employees, more than half of which in Central and Eastern Europe.

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

## The Simplified Scheme of the KBC Group

*(as at 31 December 2017)*




*Percentages in the chart denote the ownership interest.*

*1) One share is held by KBC Insurance.*
*2) Voting rights in ČSOB Pojišťovna: 40% ČSOB, 60% KBC Insurance.*

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

# KBC Group in Figures

| | | 31. 12. 2017 | 31. 12. 2016 |
|---|---|---|---|
| Total assets | EURbn | 292.3 | 275.2 |
| Loans and advances to customers | EURbn | 141.5 | 133.2 |
| Deposits from customers and debt securities | EURbn | 194.0 | 177.7 |
| Net profit, group share | EURm | 2,575 | 2,427 |
| Common equity ratio, group level (Basel III, fully loaded) | % | 16.3 | 15.8 |
| Cost / income ratio, banking part | % | 54 | 55 |

## Long-term ratings (as at 22 February 2018)

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

**Annual reports and other information about KBC are available at KBC’s corporate website www.kbc.com.**

## ČSOB as a Controlled and Controlling Entity

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

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

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

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

ČSOB did not hold any shares of KBC Bank or KBC Group between 1 January and 31 December 2017.

ČSOB is also a **controlling entity**. For information on companies controlled by ČSOB as at 31 December 2017 please refer to the chapter Companies of the ČSOB group.

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

# Corporate Social Responsibility

The fundamental philosophy of the Bank's responsible approach to society consists of a sustainable way of conducting business and as such is, essentially, simple – we try to limit the negative impact of our business everywhere we have a presence, we keep encouraging socially positive influence and motivate all of our partners, i.e. our clients, employees, suppliers, state institutions and NGOs, to act responsibly within the framework of everyday business operations. Individual activities in the field of ČSOB's social responsibility are performed in four strategic pillars and, together, form a compact unit linked to the Group sustainability strategy of the parent KBC Group.

## Strategic social responsibility pillars of ČSOB and main initiatives therein

### Financial Literacy

We have not overslept; we have started sending out our ambassadors to educate children and young people in the field of financial literacy. We provide support in the form of grants to other organisations which, identically to us, consider the topic essential for our country and its population to prosper.

We offer highly available quality financial advice in the client's choice of form (information on the bank's website, online telephone advice, personal visit to the branch).

Loans are provided to the applicants with prudently and responsibly; if the service is not provided, the reasons for the loan application denial are communicated in an open, comprehensible manner.

We provide financial education for children in primary and secondary schools. Our colleagues in the Bank who are involved in the program have given over 200 interactive talk classes to 2,000 pupils and students from 50 schools.

The ČSOB Foundation's training program focusing on improving financial literacy and security on the Internet is opened annually. Within the program, the Bank distributes CZK 1 million amongst NGO's theme projects twice a year.

We support prevention of the debt trap in cooperation with the Association of Civil Counselling Centres.

And we co-finance free debt advice and responsible deleveraging via Debt Advisory Centre – Counselling in Stringency.

### Environmental Responsibility

It is never too late to start being responsible towards our planet. We started at our own door. Our buildings are constructed in accordance with sustainable development principles. We conserve natural resources and inspire our staff members to do the same. We purchase electricity from renewable sources.

In June 2017, the ISO 14001 environmental management system was certified for the Bank Headquarters building.

The energy rating of our branches and head offices is consistently reduced thanks to modern heating and cooling systems using geothermal energy. We use LED light sources and gradually convert to autonomous light management. In the last six years, electricity consumption in ČSOB decreased by over 20%: the annual savings amount to over CZK 20 million.

We have systematically reduced the quantity of office waste which, moreover, is consistently recycled. The transition to biometric signing has achieved great savings; extensive client documentation is presently only kept on file electronically.

We reduce the frequency of company car rides, with a preference for modern technology allowing our colleagues to collaborate remotely.

Our environmental considerations are reflected in our product range, too. We offer investments in socially responsible funds, e.g. ČSOB Akciový fond vodního bohatství (ČSOB Water Equity Fund) invests in purification, desalination and infrastructure restoration in potable water supply. The ČSOB Leasing Clean Mobility project promotes unique funding and insurance for electric cars with advisory for subsidies granted within the National Action Plan for Clean Mobility.

ČSOB regularly audits the rational use of resources available, which is documented by the following information:

| Year | Water consumption ($m^3$) | Power consumption (Gj) | Paper consumption (t) | Waste generated (t) | Direct $CO_2$ emissions (t) | Indirect $CO_2$ emissions (t) |
|---|---|---|---|---|---|---|
| **2014** | 128,336 | 137,688 | 1,133 | 1,962 | 6,856 | 21,205 |
| **2015** | 125,906 | 133,010 | 1,025 | 1,965 | 5,960 | 19,696 |
| **2016** | 124,231 | 125,226 | 1,115 | 1,944 | 2,246 | 25,099 |
| **2017** | 118,679 | 59,044 | 1,029 | 1,022 | 2,867 | 17,997 |

## Entrepreneurship

We caught the right time and launched support for new entrepreneurs, small and medium enterprises and women starting with business. We know that with no innovative products and services – which constitute the backbone of the economy - can arise without support from strong partners.

We encourage the formation of co-working centres and hubs where new entrepreneurs and small enterprises can establish their back offices and initiate new business contacts, and we are involved in the preparations of Seed stars Prague, an international start-up competition.

We actively participate in public discussions, forums and expert panels where ČSOB representatives defend the interests of entrepreneurs and work to eliminate the legislative hurdles hampering small and medium enterprises.

We have become general partners of the Czech Women Entrepreneurs Award for women who exploited modern technology to establish successfully operating companies.

The ČSOB Grant Program for Social Enterprise Stabilisation is announced annually. It focuses on financial support and expert advice for companies employing individuals with challenged access to the labour market.

We have adopted a number of strict measures and policies aiming to satisfy moral obligations of a global nature (UN Global Compact, SDG, Equator principles etc.). In compliance with the Code of Conduct, Integrity Policy, Anti-Corruption Program and a number of other legal regulations, we discourage actions infringing human rights, threatening peaceful coexistence or devastating the environment.

**Longevity** (topics associated with the issues of living with a disability and of population ageing)

Time waits for no man, and age-related problems catch everyone in due time. We help you solve the problems with the benefit of our contacts in the not-for-profit sector and our knowledge of the financial pitfalls of different life stages. Our employees are involved, too: we are in this all together.

We participate in a project driven by the Sue Ryder Home Advice Centre where expert consultants assist seniors and their family members in the fields of legislation, health and palliative care and the claiming of care allowances. Together, we launched a complex advice portal called "Not getting lost in old age" in 2017, offering extensive useful and practical information.

We focus on the needs of persons with physical disability, impaired vision or hearing. We keep working towards making all our branches and advice centres absolutely barrier-free and fully accessible, we operate a transcription service (eScribe) for the deaf, navigation beacons and ATMs adjusted to the blind, and our new product creation process involves consultation of the needs of the disabled with renowned NGOs with good knowledge of the relevant issues.

Private Banking clients are offered our unique Good Will Card the specificity of which lies in direct support for philanthropy. Each Card transaction dedicates an amount, determined by the client, for the benefit of a specific charitable project. Besides, the Bank contributes to improve the living conditions for individuals in difficult situations by assigning CZK 2 million to the ČSOB Good Will Card Grant Program.

## Philanthropy at ČSOB in 2017

An inseparable part of the Bank's social responsibility which has already become a tradition is the support for philanthropy and individual donor ship development in the Czech Republic. We are interested in the needs of the Czech society; in collaboration with our NGO partners, we attempt to respond to such needs and offer appropriate solutions.

In the long term, we have collaborated with renowned NGOs like the Committee of Good Will – Olga Havel Foundation, Mathilda Foundation, Association of Civil Counsels, Counselling in Stringency, Charta 77 Foundation – the Barriers Account, Czech Radio Foundation – the Lightning Fly (Světluška) project, Sue Ryder Home, Neratov Association, Czech Paraplegic Association, Children's Helpline, Sense and Sensibility Foundation and many others. We also consider collaboration with organisations focusing on general CSR and philanthropy development in the Czech Republic important; in any matters of the current trends and future development estimates, we trust the opinions of the Donors Forum and Business for Society.

### ČSOB Helps the Regions

ČSOB Helps the Regions is a grant program promoting interesting projects which use various methods to improve the quality of the life of people all over the Czech Republic. In 2017, its two rounds of subsidy granting extended to over 112 NGOs which shared CZK 7.7 million. This amount includes financial contributions by the public, which reached almost CZK 3.5 million in 2017. The Bank's donation which the NGOs obtain based on their fundraising success at www.csobpomaharegionum.cz, amounted to CZK 4.2 million. So far, the year 2017 has been the most successful year since the program was established in 2013.

### The Education Fund

The Education Fund is our oldest philanthropic project. It was established in 1995 in cooperation with the Committee of Good Will – Olga Havel Foundation. We support talented secondary school and university students who would be unable to afford any studies due to their physical disability or social disadvantage.

Between the program launch and end of 2017, we have granted scholarships to 540 students. Another 542 students received a contributions towards their studies or learning aids. In total, we dedicated over CZK 30 million to helping young people study.

### Social Enterprise Stabilisation Grant Program

The fifth year of the grant program focusing on stabilising the existing social enterprises chose six winning projects to receive a financial incentive for their own development and expert advice of their choice. So far, 31 social enterprises have succeeded and shared an amount exceeding CZK 4.5 million. The winners of our grant program are active all over the Czech Republic and work in various areas – operating cafés, Laundromats, flower shops, creating garments, running bakeries, massage parlours etc.

### ČSOB Education programme

In the 8th year of the grant programme we have distributed CZK 2 million among 15 projects focused on financial literacy and security in the online environment. 9 supported projects dealt with the increasing of financial literacy of children from children's homes or those from socially disadvantaged backgrounds, elderly people and people with serious health disease, people after serving the sentence and single-mothers from asylum homes. Next 6 projects supported safe behaviour and sharing of information in the online environment, social networking and cyberbullying prevention for primary and secondary school pupils and hearing impaired youths.

### Volunteering

For the tenth time, Bank employees had the opportunity to use one work day for voluntary manual work or expert advisory in an NGO of their choice. In 2017, we achieved an all-time high involvement of our colleagues and recorded 1,111 individuals who helped in the regions where they live.

### Good Will Card

Since May 2017, ČSOB Private Bank clients may use the unique debit Good Will Card. It features a simple mechanism: based on a previous agreement, the clients donate the amount of 0.3%, 0.5% or 0.8% of each business transaction and the donation is dedicated to charitable purposes. Together with our clients, we help disabled children and adults or people in difficult circumstances. In the time the Good Will Card has been operational, we have raised CZK 6.8 million in total and helped more than 216 people in need.

### Together with ČSOB

A special matching fund is dedicated to the support of individual donor ship of our colleagues. Each employee may apply for a financial contribution of up to CZK 30,000 for his or her favourite NGO or charitable project. The only thing necessary is to organise any fundraising event for the benefit of his or her favourite entity, and to meet a few simple conditions (involvement of other Bank staff members, both in terms of funds and voting). The amount raised at the event is matched by the Bank (up to the limit of CZK 30,000 per project). In the course of 2017, our colleagues organised 33 fundraisers and collections for the benefit of the disabled or children's sports clubs or to subsidize hot lunches for children from socially disadvantaged families etc. Their contributions amounting to CZK 770,150 were matched by the Bank, which added CZK 676,559; so, together, we donated over CZK 1.4 million to a good cause.

## 2017 Awards

ČSOB defended its position amongst the top Czech companies in the field of Corporate Sustainability and Responsibility, CSR, and was awarded the following awards:

**Fincentrum**, the Czech financial consultancy company, declared ČSOB:

- The winner in the Bank without Barriers category

In the **TOP Responsible Company**, ČSOB was awarded by **Business for Society**:

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

**The Donors Forum** awarded ČSOB:

- The 2nd place for its Annual Social Responsibility Report – Corporate

**The Via Foundation** awarded the Good Company Award to ČSOB within the **Via Bona Awards** for exemplary long-term activity in the field of social responsibility.

*More information is available in the ČSOB Group Report to the Society 2017 and at www.csob.cz/csr.*

## Diversity

ČSOB supports equal opportunities, more women in management positions and employment of people with disabilities. The bank is eliminating pay differences between women and men in senior management roles. ČSOB is providing space for intergenerational dialogue by supporting and developing "young personnel" (Y-ČSOB) and "55plus" communities. Also makes the steps to increase the employment of employees with disabilities.

### "Diversity Rocks" – a comprehensive approach to diversity

In 2017, ČSOB carried on with the well-established diversity development projects while also broadening its focus to support **"young personnel" and "55plus" communities**. Members of the Board of Directors completed the individual mentoring cycle intended for selected female managers and we also created an open programme to raise awareness of the benefits of the diverse approach by male and female employees. The **"Male & Female Principle"** workshops will continue in 2018 for all management levels. The original community supporting the professional and personal development of female managers (Goldfish) has been renamed **"Diversity Rocks"** and is beginning to address the broader dimension of diversity at ČSOB.

### 55plus pilot programme in Client Services

The 2017 launch of the **55plus programme** was a major move towards fostering intentional diversity and professional and personal life balance. The programme was piloted among Client Services personnel and its target group included nearly 250 employees over 55 years of age. We believe that **diversity** in the broad sense of the word means **a greater spectrum of opinions and different styles of work and management** for the bank. Ultimately, diversity can lead to sustainable long-term improved performance through higher engagement and motivation of people. The objectives of the 55plus programme include using the seniority of these employees to mentor their junior colleagues, reducing pressure and stress, preventing the burnout syndrome, and providing more opportunities for regeneration, free time and re-energising.

In 2018, the pilot group will be extended to include all ČSOB 55plus employees and intense cooperation with Client Services personnel will continue.

### Balancing professional and personal life

ČSOB **offers a wide range of support activities and services** to help its employees balance their professional and personal life. These include flexible working hours, shorter working hours, telecommuting, shared roles, etc.

ČSOB runs the **Programme for Parents**, which helps mothers and fathers return from their parental leave earlier.

The result of the autumn satisfaction survey was a positive signal of what employees think about the growing activities of ČSOB focused on **diversity and professional and personal life balance**. The employee satisfaction with the ČSOB approach to these matters **increased by 15%** on 2016.



*For more information please see the 2017 ČSOB Group Report and the www.csob.cz/csr website.*

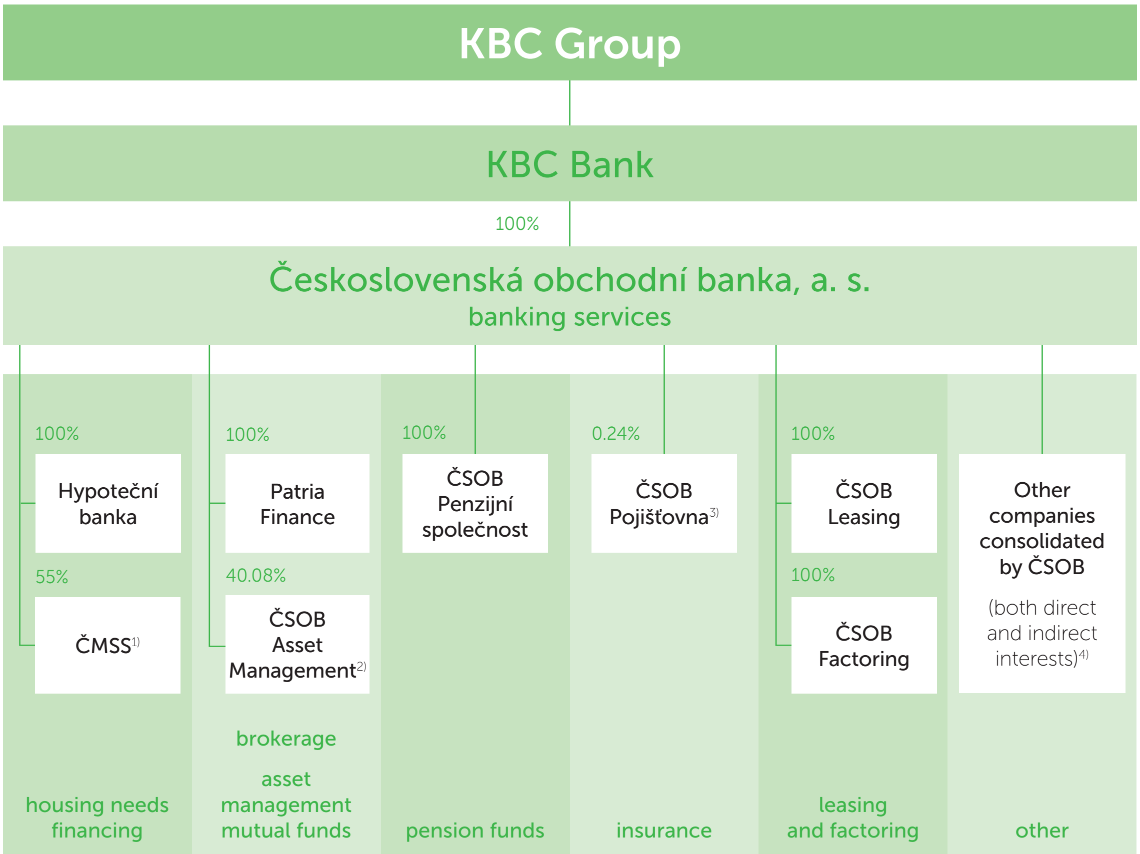
# COMPANIES OF THE ČSOB GROUP

## ČSOB group

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

As at 31 December 2017, ČSOB had ownership interests in 28 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, securities brokerage, asset management, mutual fund, pension funds, insurance, leasing and factoring.




*Percentages show ČSOB's ownership interests on company's equity as at 31 December 2017.*

*1) 45% of shares owned by Bausparkasse Schwäbisch Hall; by the equity method consolidation.*
*2) 59.92% of shares owned by KBC Participations Renta C; by the equity method consolidation.*
*3) 99.76% of shares owned by KBC Insurance; by the equity method consolidation.*
*4) A complete list of companies consolidated by ČSOB is stated in this part of ČSOB Annual Report.*

## Hypoteční banka, a.s.

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

Contact

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

| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Total assets* | CZKm | 288,314 | 262,513 |
| Loans and advances to customers* | CZKm | 280,409 | 254,078 |
| Total equity* | CZKm | 39,391 | 34,172 |
| Profit for the year after tax* | CZKm | 2,828 | 3,206 |
| Total volume of new mortgage loans (according to the Ministry of Regional Development; CZ) | CZKm | 63,392 | 63,764 |

** EU IFRS, audited.*

| | | |
|---|---|---|
| Branches | 30 | 29 |
| Agents and brokers | 4,079 | 4,164 |

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

In 2017, Hypoteční banka provided 29,895 mortgage loans in total volume CZK 63.4 bn (the second highest in the history of the bank). For the tenth time in a row HB defended its position as the market leader with a market share of 29.3% (new loans).

Last year, Hypoteční banka received the Mortgage of the year 2017 award in the category Bank of the Year for the web portal "Hypoteční zóna", which allows our clients to log in and view all information related to their mortgage loan, also provides them with opportunity to initiate changes to their mortgage loan details.

Furthermore, Hypoteční banka won two first places in the competition among banks WebTop 100 for the best website and in the category self-care for the web portal "Hypoteční zóna".

In 2017, HB moved the branch in Ostrava which is now tailored to the living room concept and officially opened the new branch in Jablonec nad Nisou.

## Českomoravská stavební spořitelna, a.s.

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

Contact

| | |
|---|---|
| Address: | Vinohradská 3218/169<br>100 17 Praha 10 |
| Telephone: | +420 225 221 111 |
| Fax: | +420 225 225 999 |
| E-mail: | info@cmss.cz |
| Internet: | www.cmss.cz |

| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Total assets* | CZKm | 149,193 | 149,536 |
| Volume of loans and bridging loans (Retail)* | CZKm | 112,599 | 114,275 |
| Volume of client deposits* | CZKm | 138,845 | 138,468 |
| Total equity* | CZKm | 9,146 | 9,741 |
| Profit for the year after tax* | CZKm | 1,043 | 1,176 |

** EU IFRS, audited.*

| | | |
|---|---|---|
| Advisory centers | 302 | 308 |
| Tied agents | 1,879 | 1,920 |

Since ČMSS was established, it has been the largest and most successful building society in the Czech market from the point of view of the balance sheet total CZK 149.2 bn as at 31 December 2017 and of the realised profit in the year 2017 it amounted to CZK 1.043 bn. In the long run, it has been the biggest provider of the building savings product (in the year 2017, the volume of the new savings contracts amounted to CZK 60.5 bn, which represented a market share of 38%) and of building savings loans (new loans provided in the year 2017 amounted to a total of CZK 22.2 bn, which was a market share of 40.1%*).

Currently, 1.2 million clients have building savings or a building savings loan from ČMSS. In addition, ČMSS is also an important provider of other products from the ČSOB group, namely: life risk insurance, supplementary pension savings, mortgage loans, investment life insurance, property and liability insurance and current accounts. These sales are made thanks to an extensive network of sales advisors, which consists of almost 1,900 advisors.

**estimation*

## Patria Finance, a.s.

| | |
|---|---|
| Date of establishment: | 23. 5. 2001 |
| Business activities: | the securities services |
| Identification number | 26455064 |
| Registered capital: | CZK 150,000 ths |
| Shareholders: | 100% ČSOB |

PATRIA FINANCE

Contact

| | |
|---|---|
| Address: | Jungmannova 745/24<br>110 00 Praha 1 |
| Telephone: | +420 221 424 240 |
| Fax: | +420 221 424 179 |
| E-mail: | info@patria-direct.cz |
| Internet: | www.patria-direct.cz |

| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Profit for the year after tax (Patria group)* | CZKm | 12 | 37 |
| | | | |
| Number of orders realized through personal brokers and the online trading platform WebTrader (Patria Finance) | ca. | 124,100 | 157,900 |
| Number of clients (Patria Finance) | ca. | 25,000 | 23,000 |

** EU IFRS, unaudited.*

The main activity of Patria Finance is the provision of investment banking services in the areas of securities trading and the provision of information on financial and capital markets through the Internet platform www.patria.cz. Patria Finance services also include investment research, both for the CEE region and the developed markets of Western Europe and the USA. Securities trading and brokerage is offered through the Internet portal www.patria-direct.cz.

In 2017, securities trading focused dominantly on stock markets. Patria Finance, serves more than 25,000 clients with the volume of AUM exceeding CZK 36 bn.

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

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

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 |

| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Total assets managed by ČSOB AM[1)] | CZKm | 219,861 | 208,327 |
| Total assets in funds distributed by the ČSOB group[1), 2)] | CZKm | 106,789 | 100,124 |
| Market share (according to methodology of AKAT) – total assets in funds | | 22.1% | 23.2% |

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

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

In 2017, ČSOB AM launched on the market more than 20 funds, which are mostly structured. The offer for ČSOB Private Banking Wealth Office clients was extended by a new fund ČSOB Wealth Office I. In September 2017, apart from many thematic funds focused, amongst other things, on information technologies or silver economy, ČSOB AM introduced the unique mixed funds ČSOB Expertiza vyvážená and ČSOB Expertiza růstová, which, apart from using various investment techniques, put particular emphasis on the effort to mitigate the risk of decline. ČSOB AM was awarded the first place in the category Guaranteed Funds with the structured fund ČSOB Exkluzivní evropský jumper 1 in the 2017 Finparáda Financial Product of the Year competition. Furthermore, for year 2017 ČSOB was awarded prestigious award Europe Structured Products and Derivatives Awards for the best distribution and performance of the structured products in the Czech Republic.

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

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

Penzijní společnost

Contact

| | |
|---|---|
| Address: | Radlická 333/150<br>150 57 Praha 5 |
| Telephone: | +420 495 800 600 |
| Fax: | +420 224 119 536 |
| E-mail: | csobps@csob.cz |
| Internet: | www.csob-penze.cz |

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

| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Funds registered in favour of participants of the Transformed fund Stabilita | CZKm | 44,909 | 42,320 |
| - of which contributions of participants | CZKm | 35,627 | 33,400 |
| Participant funds in participation funds | CZKm | 4,501 | 2,986 |
| Profit for the year after tax* | CZKm | 132 | 143 |

** EU IFRS, audited.*

| | | | |
|---|---|---|---|
| Customers | ca. | 631,000 | 636,000 |

Pension savings perceived as a basic savings product for each of us. The aim of ČSOB Penzijní společnost is to create responsible clients and pension savings makes clients responsible. Clients are offered simple and effective solutions that help in arranging pension savings and its use, online way included.

Company is one of market leaders in area of pension savings for children, with market share exceeding 27%.

In 2017, the company trusted more than 630,000 clients who have entrusted it with more than CZK 49 bn.

## 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: | | |
| *Registered capital* | 99.76% | KBC Insurance |
| | 0.24% | ČSOB |
| *Voting rights* | 60% | KBC Insurance |
| | 40% | ČSOB |

ČSOB Pojišťovna

Contact

| | |
|---|---|
| Address: | Masarykovo nám. 1458<br>532 18 Pardubice,<br>Zelené předměstí |
| Telephone: | +420 467 007 111<br>+420 800 100 777 |
| Fax: | +420 467 007 444 |
| E-mail: | info@csobpoj.cz |
| Internet: | www.csobpoj.cz |

| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Total assets* | CZKm | 44,170 | 42,220 |
| Total equity* | CZKm | 4,460 | 4,936 |
| Profit for the year after tax* | CZKm | 859 | 869 |
| Gross written premium life insurance | CZKm | 6,852 | 7,318 |
| Gross written premium non-life insurance | CZKm | 5,922 | 5,275 |

** EU IFRS, audited.*

| | | | |
|---|---|---|---|
| Branches | | 97 | 92 |
| Customers, comprising individuals and business entities, including small and medium-sized businesses, as well as large corporations | ca. | 1,184,000 | 1,079,000 |

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

In 2017, ČSOB Pojišťovna posted a net profit of CZK 859 m mainly thanks to good business results. Gross written premium reached CZK 12.8 bn. Market share increased by 0.4 percentage point to 7.5% in 2017.

# ČSOB Leasing, a.s.

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

Contact

| | |
|---|---|
| Address: | Na Pankráci 310/60<br>140 00 Praha 4 |
| Telephone: | +420 222 012 111 |
| Fax: | +420 271 128 028 |
| E-mail: | info@csobleasing.cz |
| Internet: | www.csobleasing.cz |


| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Total assets[1)] | CZKm | 45,538 | 40,470 |
| Amounts due from clients (gross)[1)] | CZKm | 40,161 | 36,222 |
| Total equity[1)] | CZKm | 9,235 | 8,064 |
| Profit for the year after tax[1)] | CZKm | 380 | 487 |
| Volume of new leasing business[2)] | CZKm | 19,694 | 17,898 |

*1) EU IFRS, unaudited.*
*2) According to methodology of Czech Leasing and Finance Association (ČLFA); Initial investment*

| | | |
|---|---|---|
| Sale offices | 14 | 10 |

ČSOB Leasing is a universal leasing company, ranked the top non-bank financial service provider in the Czech Republic (according to the statistics published by the Czech Leasing and Finance Association).

ČSOB Leasing provides a broad range of services to its clients: finance leases, leaseback, releasing, customer loan, full-service leases, operating leases, fleet management for financing the acquisition or use of light and heavy transport equipment, machinery, devices, IT equipment, technologies and technological units, including financing of high-cost items.

ČSOB Leasing concluded more than 21 thousands of contracts and provided financing in the amount of CZK 19.7 bn in 2017.

## 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

| | |
|---|---|
| Address: | Benešovská 2538/40<br>101 00 Praha 10 |
| Telephone: | +420 267 184 805 |
| Fax: | +420 267 184 822 |
| E-mail: | info@csobfactoring.cz |
| Internet: | www.csobfactoring.cz |

| Indicator | | 2017 | 2016 |
|---|---|---|---|
| Total assets* | CZKm | 6,355 | 5,261 |
| Amounts due from clients (gross)* | CZKm | 6,661 | 5,563 |
| Total equity* | CZKm | 1,061 | 914 |
| Profit for the year after tax* | CZKm | 98 | 81 |
| Turnover of receivables | CZKm | 37,599 | 33,261 |

** EU IFRS, unaudited.*

ČSOB Factoring has been providing factoring services to its clients for more than twenty five years. Thanks to the quality of service the company keeps the market share over 20%.

In 2017, the volume of receivables assigned to ČSOB Factoring increased by 13% and reached CZK 37.6 bn.

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

# Companies of the ČSOB Group

*(as at 31 December 2017)*

| 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 (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 |
| 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 and related services | Praha 10, Benešovská 2538/40 | 70,800,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 63998980 | **ČSOB Leasing, a.s.**<br>Leasing | Praha 4, Na Pankráci 310/60 | 3,050,000,000 | 100.00 | 100.00 | none | 100.00 | 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 |
| 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 | 5,076,336,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 02623111 | **SousedeCZ s.r.o.**<br>Development of housing community network | Praha 5, Radlická 333/150 | 10,000 | 100.00 | none | 100.00 | 100.00 | Hypoteční banka | Y |
| 00000949 | **MOTOKOV a.s. in liquidation**<br>Wholesale of machines and technical equipment | Praha 5, Radlická 333/150 | 62,000,000 | 70.09 | 0.50 | 69.59 | 70.09 | ČSOB Advisory | Y |
| 26455064 | **Patria Finance, a.s.**<br>Securities trader | Praha 1, Jungmannova 745/24 | 150,000,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 25671413 | **Patria Corporate Finance, a.s.**<br>Brokerage activities in financial consulting | Praha 1, Jungmannova 745/24 | 1,000,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 05154197 | **Patria investiční společnost, a.s.**<br>Management of investment funds | Praha 1, Jungmannova 745/24 | 10,000,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| 00604054 | **Burza cenných papierov v Bratislave, a.s.**<br>Stock exchange activity | SR, Bratislava, Vysoká 17 | 291,281,843 | 11.77 | 11.77 | none | 11.77 | none | 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 |
| 27388239 | **Top-Pojištění.cz s.r.o.**<br>Arranging insurance | Praha 4, Lomnického 1705/9 | 200,000 | 100.00 | 100.00 | none | 100.00 | none | Y |
| **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 |

| ID No. | Legal Entity: Business Name of Legal Entity / Business Activities | Registered Office | Registered Capital (CZK) | Share of ČSOB in Registered Capital: Total (%) | Share of ČSOB in Registered Capital: Direct (%) | Share of ČSOB in Registered Capital: Indirect (%) | Share of ČSOB in Voting Rights (%) | Indirect Share of ČSOB via | Cons. EU IFRS (Y/N) |
|---|---|---|---|---|---|---|---|---|---|
| 28985362 | **ENGIE 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** [1]<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** [2]<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 | 0.00 | ČSOB Pojišťovna | Y |
| 24776815 | **STRM Delta, a.s.**<br>Rent of flats and non-residential spaces | Praha 1, Vladislavova 1390/17 | 2,001,387 | 0.24 | none | 0.24 | 0.00 | ČSOB Pojišťovna | Y |
| 05815614 | **Pardubická Rozvojová, a.s.**<br>Rent of flats and non-residential spaces | Pardubice, Zelené předměstí, Masarykovo náměstí 1458 | 2,000,000 | 0.24 | none | 0.24 | 0.00 | ČSOB Pojišťovna | Y |
| 45316619 | **IP Exit, a.s.** [3] **– in bankruptcy**<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 |

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

*1) 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%.*

*2) Shares in registered capital: ČSOB 0.24%, KBC Insurance 99.76%; shares in voting rights: ČSOB 40%, KBC Insurance 60%.*

*3) Shares in registered capital: ČSOB 71.29%, ČSOB Advisory 14.34%, ČSOB Pojišťovna 0.11%; shares in voting rights: ČSOB 71.29%, ČSOB Advisory 14.34%.*

## Changes in 2017

*ČSOB Property fund, a.s. (CZ; ID No.: 27924068): "in liquidation" – company dissolved as of 26 January 2018.*

*Merrion Properties s.r.o. (CZ; ID No.: 25617184): "in liquidation" – company dissolved as of 13 November 2017.*

*Patria Online, a.s. (CZ; ID No.: 61859273) – merger into ČSOB as of 1 December 2017.*

*Centrum Radlická, a.s. (CZ; ID No.: 26760401) – merger into ČSOB as of 1 December 2017.*

*Pardubická Rozvojová, a.s. (CZ; ID No.: 05815614) – establishment of subsidiary of ČSOB Pojišťovna, a.s. as of 16 February 2017.*

*STRM Delta, a.s. (CZ; ID No.: 24776815) – acquisition of 100% ownership stake Pardubická Rozvojová, a.s. as of 7 November 2017.*

*Tee Square Ltd. – a record of the branch was erased from the Commercial Register on the day of February 21, 2017.*

*Burza cenných papierov v Bratislave, a.s. (SR; ID No.: 00604054) – new direct participation of ČSOB as a consequence of merger of Patria Online, a.s. into ČSOB as of 1 December 2017.*

*Patria Investiční společnost, a.s. (CZ; ID No.: 05154197) – new direct participation of ČSOB as a consequence of merger of Patria Online, a.s. into ČSOB as of 1 December 2017.*

*Patria Finance, a.s. (CZ; ID No.: 26455064) – new direct participation of ČSOB as a consequence of merger of Patria Online, a.s. into ČSOB as of 1 December 2017.*

*Patria Corporate Finance, a.s. (CZ; ID No.: 25671413) – new direct participation of ČSOB as a consequence of merger of Patria Online, a.s. into ČSOB as of 1 December 2017.*

# CORPORATE GOVERNANCE

## Managing and Supervisory Bodies

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

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

### The Board of Directors in 2017

| First Name and Surname | Position | Membership since | Current Term in Office since[1] | ČSOB's Top Management[4] Position and Area of Responsibility |
|---|---|---|---|---|
| **John Arthur Hollows** | Chairman[2] | 1. 5. 2014 | 1. 5. 2014 | Chief Executive Officer |
| **Marek Ditz** | Member | 1. 1. 2013 | 2. 1. 2017[3] | Senior Executive Officer, Transformation |
| **Petr Knapp** | Member | 20. 5. 1996 | 21. 5. 2014[3] | Senior Executive Officer, Relationship Services |
| **Petr Hutla** | Member | 27. 2. 2008 | 1. 3. 2017[3] | Senior Executive Officer, Retail[5] |
| **Jiří Vévoda** | Member | 8. 12. 2010 | 9. 12. 2015[3] | Senior Executive Officer, Finance Management |
| **Tomáš Kořínek** | Member | 1. 1. 2015 | 1. 1. 2015 | Senior Executive Officer, Group Risk Management |
| **Marcela Suchánková** | Member | 1. 3. 2017 | 1. 3. 2017 | Senior Executive Officer, People and Communication |
| **Jan Sadil** | Member | 1. 3. 2017 | 1. 3. 2017 | Senior Executive Officer, Specialized Banking and Insurance[6] |

*1) The term in office of the members lasts four years.*
*2) Chairman since 2 May 2014.*
*3) Elected to a new term in office.*
*4) In 2017, members of ČSOB's Top Management were identical with the members of the Board of Directors of ČSOB.*
*5) Senior Executive Officer of Credits Management since 1 March 2018.*
*6) Senior Executive Officer of Retail since 1 March 2018.*

**For a description of areas of responsibility managed by ČSOB's Board of Directors** (Top Management) as at 31 December 2017 please refer to ČSOB's Organisation Chart, page 64 of this Annual Report. Descriptions of work and decision-making processes are given in Corporate Governance chapter of this Annual Report, page 58.

## The Supervisory Board in 2017

| First Name and Surname | Position | Membership since | Current Term in Office since[1)] | Termination of Membership |
|---|---|---|---|---|
| **Pavel Kavánek** | Chairman[2)] | 1. 5. 2014 | 1. 5. 2014 | – |
| **Franky Depickere** | Member | 1. 6. 2014 | 1. 6. 2014 | – |
| **Christine Van Rijsseghem** | Member | 1. 6. 2014 | 1. 6. 2014 | – |
| **Willem Hueting** | Member | 1. 7. 2016 | 1. 7. 2016 | – |
| **Marc Wittemans** | Member | 1. 10. 2016 | 1. 10. 2016 | – |
| **Petr Šobotník** | Member | 1. 2. 2017 | 1. 2. 2017 | – |

*1) The term in office of the members lasts four years.*
*2) Chairman since 30 June 2014.*

## The Audit Committee in 2017

| First Name and Surname | Position | | Membership since | Termination of Membership |
|---|---|---|---|---|
| **Petr Šobotník** | Chairman[1)]; Independent member | Member of ČSOB's Supervisory Board (since 1. 2. 2017) | 1. 2. 2011 | – |
| **Ladislav Mejzlík** | Independent member | Not a member of any ČSOB body | 27. 1. 2016 | – |
| **Willem Hueting**[2)] | Member | Member of ČSOB's Supervisory Board (since 1. 7. 2016) | 1. 7. 2016 | – |

*1) Chairman since 7 April 2016.*
*2) Acting in KBC Group as the Senior General Manager, Group Communities (Business Unit International Markets).*

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

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

#### On 6 December 2016

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

#### On 18 January 2017

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

#### On 27 February 2017

- Marcela Suchánková was elected a member of ČSOB' Board of Directors with effect from 1 March 2017.
- Jan Sadil was elected a member of ČSOB' Board of Directors with effect from 1 March 2017.

## Changes in ČSOB's Managing and Supervisory Bodies in 2018

### On 27 February 2018

- Tomáš Kořínek was removed from ČSOB' Board of Directors with effect from 28 February 2018.
- Hélène Goessaert was elected a member of ČSOB's Board of Directors with effect from 1 March 2018.

## The Composition of ČSOB's Board of Directors since 1 March 2018:

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

For a description of areas of responsibility managed by ČSOB's Board of Directors (Top Management) since 1 March 2018 please refer to ČSOB's Organization Chart, page 65 of this Annual Report. Abbreviated curriculum vitaes of the members of the Board of Directors can be found of page 50.

## Conflict of Interests

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

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

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

## The Business Address

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

**Československá obchodní banka, a. s.**
**Radlická 333/150**
**150 57 Praha 5**
**Czech Republic**

# INTRODUCING MEMBERS OF MANAGING AND SUPERVISORY BODIES

## ČSOB's Board of Directors in 2017

### JOHN ARTHUR HOLLOWS

*Born on 12 April 1956*

Chairman of the Board of Directors

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

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

*Membership in bodies of other companies:*
- Member of the Executive Committee of the KBC Group (Belgium)
- Member of the Board of Directors and member of the Executive Committee of KBC Bank (Belgium) and KBC Insurance (Belgium)

### MAREK DITZ

*Born on 16 September 1972*

Member of the Board of Directors

Transformation

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

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

*Membership in bodies of other companies:*
- None

## PETR KNAPP

*Born on 7 May 1956*

Member of the Board of Directors

Relationship Services

He graduated from the University of Economics, Prague.

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

*Membership in bodies of other companies:*
- Chairman of the Supervisory Board in: ČSOB Factoring (CZ) and ČSOB Leasing (CZ)
- Member of the Supervisory Board in: Patria Online (CZ), Patria Finance (CZ) and Patria Corporate Finance (CZ)
- Member of the Board of Directors of the Prague Economic Chamber (CZ)
- Member of the Board of Trustees of the University of Chemistry and Technology, Prague (CZ)
- Member of the Committee of UNIJAZZ – Association for the support of cultural activities
- Member of the Board of Trustees of the Buďánka, z. ú.

## PETR HUTLA

*Born on 24 August 1959*

Member of the Board of Directors

Retail

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

Mr. Hutla worked for Tesla Pardubice between 1983 and 1993, as the Economic Associate Director of Tesla Pardubice – RSD from 1991. He has been working for ČSOB since 1993: first as the branch manager in Pardubice and the main branch manager in Hradec Králové, then as the main branch manager in Prague 1. Mr. Hutla then served as Senior Director, Corporate and Institutional Banking (between 2000 and 2005). He has worked as Senior Executive Officer since 2005: Personnel and Strategic Management (between 2005 and 2006), Human Resources and Transformation (between 2006 and 15 November 2009), Distribution (between 16 November 2009 and 31 December 2012). Since 27 February 2008, Mr. Hutla has been a member of the Board of Directors. From 14 January 2009 to 31 December 2011, he was also the head of KBC Global Services Czech Branch, organizational unit. Between January 2013 and June 2014, Mr. Hutla was a member of ČSOB's Top Management as the Senior Executive Officer, Specialized Banking and Insurance. From 1 July 2014 to 9 March 2015, he was a member of ČSOB's Top Management responsible for Convenient Retail Services and from 1 October 2014 to 9 March 2015, also responsible for Change Zone; Mr. Hutla was responsible for Retail (after the merger of these two management areas) from March 2015 to January 2018. As of February 2018 Mr. Hutla has been in charge of Credits Management.

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

**JIŘÍ VÉVODA**

*Born on 4 February 1977*

Member of the Board of Directors

Finance Management

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

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

*Membership in bodies of other companies:*
- Member of the Supervisory Board in: Hypoteční banka (CZ), ČSOB Leasing (CZ), ČMSS (CZ)
- Chairman of the Supervisory Board in: Patria Finance (CZ) and Patria Corporate Finance (CZ)

**TOMÁŠ KOŘÍNEK**

*Born on 10 June 1967*

Member of the Board of Directors

Group Risk Management

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

Upon his graduation Mr. Kořínek held senior management positions at several financial institutions in the Czech Republic. Before joining ČSOB, he worked as a member of Volksbank CZ Board of Directors responsible for risk management, finance and operations. He has been working for ČSOB since April 2009; between May 2010 and October 2013, as a Director of Risk Management Department and from November 2013 to 31 December 2014, as the Executive Director responsible for Group Risk Management. Mr. Kořínek was a member of ČSOB's Board of Directors responsible for Group Risk Management (CRO), Compliance and Legal from 1 January 2015 to 28 February 2018. As of 1 March 2018 Mr. Kořínek has been appointed as CEO and Chairman of the Board of Directors in ČMSS.

*Membership in bodies of other companies:*
- Chairman of the Audit Committee of Hypoteční banka (CZ)
- Member of the Audit Committee in ČMSS (CZ) and ČSOB Pojišťovna (CZ)
- Member of Supervisory Board in ČSOB Pojišťovna (CZ)

**MARCELA SUCHÁNKOVÁ**

*Born on 3 January 1971*

Member of the Board of Directors

People and Communication

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

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

*Membership in bodies of other companies:*
- None

**JAN SADIL**

*Born on 16 February 1969*

Member of the Board of Directors

Specialized Banking and Insurance

He graduated from the Civil Engineering Faculty of the Czech Technical University in Prague and University of Economics and the Institute of Forensic Engineering of University of Technology in Brno (postgraduate studies).

Mr. Sadil started his banking career in Komerční banka, a.s. in 1995. In 2000, he was appointed as the manager responsible for private individuals loans division. In 2001, he joined Českomoravská hypoteční banka, a.s. (currently Hypoteční banka, a.s.) as a member of the Board of Directors responsible for sales and marketing. Since the end of 2003 till March 2017, he hold the position of Chairman of the Board of Directors and the CEO of Hypoteční banka. As of 1 March 2017, he has been appointed as a member of ČSOB's Board of Directors responsible for Specialised Banking and Insurance. Since 1 February 2018 he has been responsible for Retail.

*Membership in bodies of other companies:*

- Member of the Supervisory Board in: Českomoravská stavební spořitelna, a.s. (CZ), ČSOB Pojišťovna, a.s. (CZ), Centrum Paraple, o.p.s. (CZ)
- Chairman of the Supervisory Board in Hypoteční banka (CZ), Via Cordata, o.p.s (CZ), Association for Real Estate Market Development (CZ)

## New members of Board of directors as of 1 March 2018

**HÉLÈNE GOESSAERT**

*Born on 3 April 1965*

Member of the Board of Directors

Group Risk Management

Ms. Goessaert graduated from Ghent University, Belgium and after gaining that Post graduate degree in Financial Sciences, Vlerick School for Management.

In March 2018 Hélène Goessaert joined to ČSOB from the Belgian headquarters of KBC. She has worked at KBC since 1990. In 2002, she assumed the position of the Head of Market Risks, where she was responsible for the monitoring of the worldwide market risk in KBC Group. From 2007, she worked as the General Manager Market Risks. In that position, she led the Market risk and Modeling team. As of 2010, she became responsible for the risk management strategy for trading and corporate banking activities. In 2011, she became a member of the Management Committee, responsible for the financial reporting and performance measurement. In the same year, she also became a member of the Finance Committee of KBC Group, deciding on the strategy for the Finance function of the Group. Since 2015, she hold the post of the Chief Data Manager, responsible for the Data and Reporting Architecture of KBC Group from 2015 to 28 February 2018.

*Membership in bodies of other companies:*

- Member of the Audit Committee of ČSOB Pojištovna (CZ), ČMSS (CZ), Hypoteční banka (CZ)

# ČSOB's Supervisory Board

**PAVEL KAVÁNEK**
*Born on 8 December 1948*

Chairman of the Supervisory Board

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

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

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

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

*Membership in bodies of other companies:*
- President of the Executive Board of the Czech Banking Association (CZ)
- Member of the Board of Trustees of the Aspen Institute Prague (CZ)

**FRANKY DEPICKERE**
*Born on 26 January 1959*

Member of the Supervisory Board

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

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

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

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

## CHRISTINE VAN RIJSSEGHEM

*Born on 24 October 1962*

Member of the Supervisory Board

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

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

Since 1 June 2014, she has been a member of ČSOB's Supervisory Board. Ms. Van Rijsseghem is also a Member of the Risk and Compliance Committee (Chairman) and Nomination and Remuneration Committee (Chairman).

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

## WILLEM HUETING

*Born on 16 February 1962*

Member of the Supervisory Board

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

Mr. Hueting has more than 30 years experiences in banking and insurance industry. He gained his experience in ABN AMRO in life insurance, investment funds, private banking, marketing, product and project management where he held several positions in the Netherlands and in Hungary. From 2001 to 2006, he was appointed as the member of the Board of Directors in Raiffeisen International Bank Czech Republic, responsible for distribution network, marketing and quality, central project office and overall reorganisation programme. Mr. Hueting joined the KBC Group in 2007 as a member of the Board KBC Consumer Finance International. After this he worked also as a Chief Executive Officer in ČSOB Poisťovňa (SK) and CEO Consumer Finance International KBC Group. Since May 2016, Mr. Hueting has been appointed as the Senior General Manager, Group Communities Banking (Business Unit International Markets)&Consumer Finance in KBC Group.

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

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

## MARC WITTEMANS

*Born on 8 February 1957*

Member of the Supervisory Board

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

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

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

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

## PETR ŠOBOTNÍK

*Born on 16 May 1954*

Member of the Supervisory Board

Mr. Šobotník graduated from the University of Economics, Prague.

Between 1983 and 1991, he acted as a chief accountant in corporations as well as in governmental bodies. Petr joined Coopers & Lybrand in 1991, was promoted to Partnership in 1995 and worked in various top management assurance positions in both Coopers & Lybrand and PricewaterhouseCoopers till 2010. From 2007 to 2014, he was the President of the Czech Chamber of Auditors. At present, Mr. Šobotník is an independent consultant (Šobotník & Partners).

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

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

*Membership in bodies of other companies:*
- Representative of the Czech Republic in Accountancy Europe – Ethics Working Party (since 2004)
- Chairman of the Audit Committees of Český Aeroholding (since February 2014; CZ), ČEPRO (since January 2016; CZ), Severomoravské vodovody a kanalizace (since May 2017; CZ) and Kofola ČeskoSlovensko (since June 2017; CZ)
- Member of the Audit Committee of ČSOB Penzijní společnost (since March 2016; CZ)
- Vice-chairman of Letiště Praha's Supervisory Board (since April 2017; CZ)

## ČSOB's Audit Committee

**LADISLAV MEJZLÍK**

*Born on 1 May 1961*

Independent member of the Audit Committee

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

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

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

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

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

# Corporate Governance Policy

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

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

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

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

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

## General Meeting

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

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

## Board of Directors

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

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

**At the end of 2017, ČSOB's Board of Directors had eight members and worked in the following composition:** John Arthur Hollows (Chairman), Petr Hutla, Petr Knapp, Jiří Vévoda, Marek Ditz, Tomáš Kořínek, Marcela Suchánková and Jan Sadil.

*Personnel changes in ČSOB's Board of Directors during the year 2017 are described in the chapter Managing and Supervisory Bodies.*

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

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

## Board of Directors Committees

### Risk and Capital Oversight Committee (RCOC)

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

Chairman of the Committee: Tomáš Kořínek

### Credit Sanctioning Committee (CSC)

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

Chairman of the Committee: Jiří Vévoda

### Enterprise Architecture Board (EAB)

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

Chairman of the Committee: John Arthur Hollows

### Public Affairs Committee (PAC)

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

Chairman of the Committee: Petr Hutla

### ČSOB Corporate Social Responsibility Committee (CSRC)

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

Chairman of the Committee: John Arthur Hollows

### Crisis Committee (CRC)

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

Chairman of the Committee: John Hollows

### Other Bodies

### EXCO – Executive Committee Relationship Services

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

### EXCO – Executive Committee for Retail Clients

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

### EXCO – Integrate, Simplify, Innovate

The Committee works as a joint platform composed of representatives of ICT, Project and Enterprise Architecture, Consumer Finance and Payments, Operations, Procurement, Data, Innovation including the representatives of Retail and Relationship Services, Design and Finance.

The main objective of the body is to coordinate the actions of these units, especially in the areas of innovations, projects, prioritisation, roadmaps, finance and legislation. At the same time the aim of the committee is to look for new joint opportunities and exchange of experiences in accordance with the powers delegated by ČSOB's Board of Directors and ČSOB group strategic plan.

## Supervisory Board

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

**At the end of 2017, ČSOB's Supervisory Board had six members and worked in the following composition:** Pavel Kavánek (Chairman), Christine Van Rijsseghem, Franky Depickere, Marc Wittemans, Willem Hueting and Petr Šobotník.

*Personnel changes in ČSOB's Supervisory Board during the year 2017 are described in the chapter Managing and Supervisory Bodies.*

In compliance with its plan of work, the Supervisory Board held **four meetings in 2017** where it discussed issues falling under its responsibility according to the Articles of Association of ČSOB. Reading materials for meetings of the Supervisory Board were prepared and delivered well in advance for the members of the Supervisory Board to have enough time to study them. Meetings of the Supervisory Board are also regularly attended by the members of the Board of Directors who personally present submitted materials. In compliance with its powers and based on the Audit Committee recommendation, the Supervisory Board selects an external auditor prior the official appointment by the General Meeting of shareholders. The auditor attends all meetings of the Audit Committee, thus providing an independent, comprehensive and qualified opinion of whether ČSOB's financial statements reflect ČSOB's situation and performance correctly in all material respects. Pursuant to the Rules of Procedure of the Supervisory Board, administrative and organizational support is provided by the Corporate Secretary, who is responsible for taking the minutes of the meetings. Constitution of a quorum and majority necessary to adopt a decision follow the same principles as in case of the Board of Directors. Supervisory Board meetings are governed by the Articles of Association of ČSOB and by its rules of procedure.

## Supervisory Board Committees

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

### Nomination and Remuneration Committee

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

**In 2017, the Nomination and Remuneration Committee was composed of the following members** Christine Van Rijsseghem, Pavel Kavánek and Willem Hueting.

The Nomination and Remuneration Committee held **four meetings in 2017**.

### Risk and Compliance Committee

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

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

**In 2017, the Risk and Compliance Committee worked in the following composition:** Christine Van Rijsseghem (Chairman), Pavel Kavánek, Willem Hueting a Petr Šobotník (independent Chairman of ČSOB's Audit Committee, member of Supervisory Board since 1 February 2017).

The Risk and Compliance Committee held **four meetings in 2017**.

## Audit Committee

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

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

**In 2017, the Audit Committee worked in the following composition:** Petr Šobotník (independent Chairman), Ladislav Mejzlík (independent member) and Willem Hueting.

The Audit Committee held **four meetings in 2017**.

# Internal Control Mechanisms to Minimize Financial Reporting Process Risks

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

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

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

Accounting procedures and valuation rules for assets and liabilities including rules for provisions and allowances are defined within internal regulations prepared in accordance with the legal requirements and international financial reporting standards. Monitoring of compliance with the requirements and incorporation of changes is provided by Accounting Methodology in cooperation with the units concerned. Applicable accounting policies, e.g. rules for valuation financial assets or principles of creation of allowances and provisions, are described in Note 2 to the Separate Financial Statement for the year 2017 prepared in accordance with EU IFRS and in Note 2 to the Consolidated Financial Statement for the year 2017 prepared in accordance with EU IFRS.

Control mechanisms are extended based on recommendations from internal audit, or based on outcomes of the risk assessment reviews organized as a part of the operational risk management, please refer to Note 38.5 to the Separate Financial Statement for the year 2017 prepared in accordance with EU IFRS and to Note 40.5 to the Consolidated Financial Statement for the year 2017 prepared in accordance with EU IFRS.

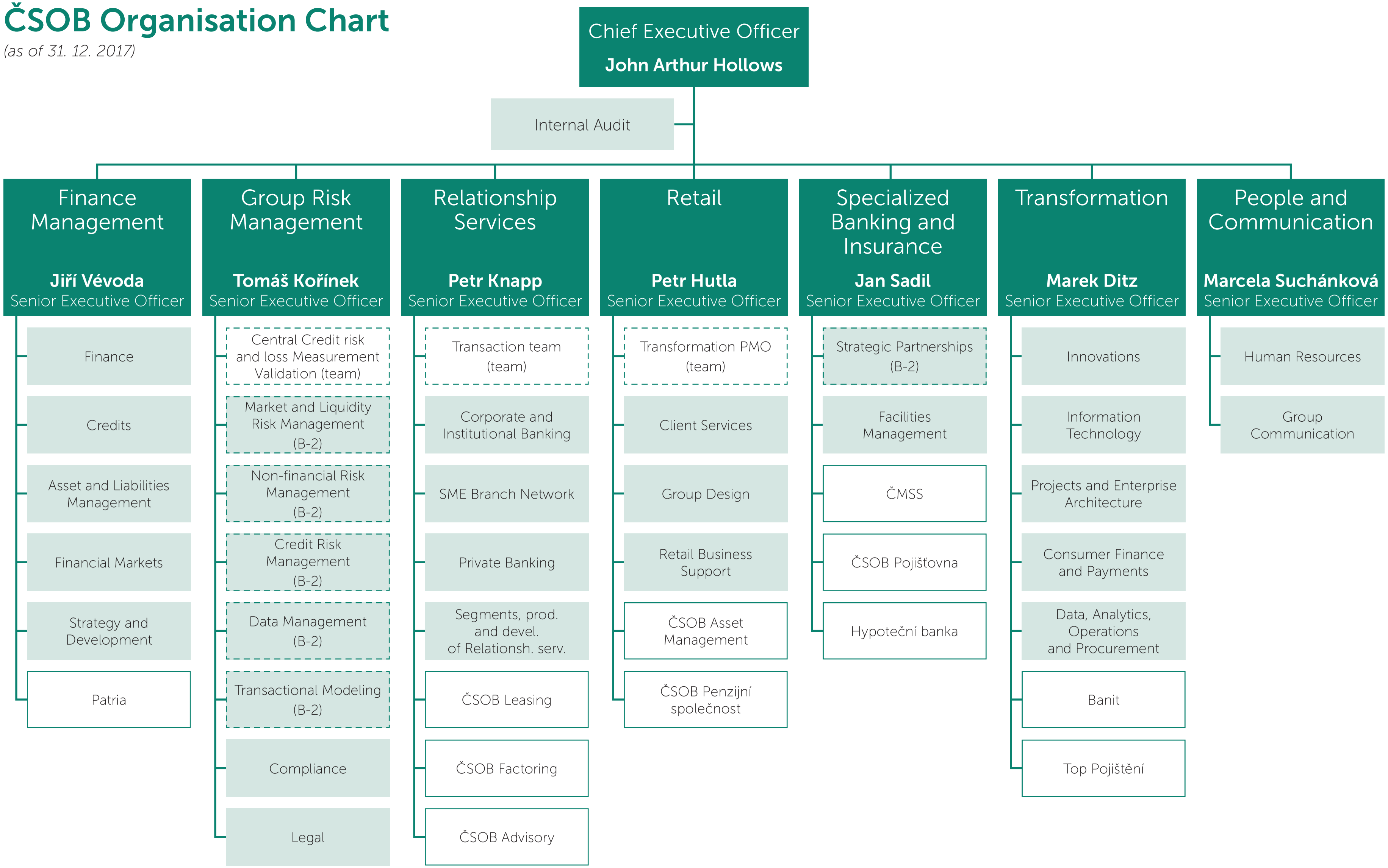
Majority of financial statements is generated automatically using the data from the central data warehouse, reconciled to the General Ledger balances.

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

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

# ČSOB Organisation Chart

*(as of 31. 12. 2017)*



# ČSOB Organisation Chart

*(as of 1. 3. 2018)*[1)]

**Chief Executive Officer**
**John Arthur Hollows**

- Internal Audit
- Strategy and Development

**Finance Management** – **Jiří Vévoda**, Senior Executive Officer
- Group Investments Center (B-3)
- Finance
- Asset and Liabilities Management
- Financial Markets
- Patria
- ČSOB Asset Management

**Group Risk Management** – **Hélène Goessaert**, Senior Executive Officer
- Central Credit risk and loss Measurement Validation (team)
- Market and Liquidity Risk Management (B-2)
- Non-financial Risk Management (B-2)
- Credit Risk Management (B-2)
- Data Management (B-2)
- Transactional Modeling (B-2)
- Compliance

**Relationship Services** – **Petr Knapp**, Senior Executive Officer
- Transaction team (team)
- Corporate and Institutional Banking
- SME Branch Network
- Private Banking
- Segments, prod. and devel. of Relationsh. serv.
- ČSOB Leasing
- ČSOB Factoring
- ČSOB Advisory

**Retail** – **Jan Sadil**, Senior Executive Officer
- Transformation PMO (team)
- Client Services
- Group Design
- Retail Business Support
- ČSOB Pojišťovna

**Credits Management** – **Petr Hutla**, Senior Executive Officer
- Corporate Social Responsibility (team)
- Credits
- Legal
- ČMSS

**Transformation** – **Marek Ditz**, Senior Executive Officer
- Strategic Partnerships (B-2)
- Innovations
- Information Technology
- Projects and Enterprise Architecture
- Consumer Finance and Payments
- Data, Analytics, Operations and Procurement
- Banit
- Top Pojištění

**People and Communication** – **Marcela Suchánková**, Senior Executive Officer
- Human Resources
- Group Communication
- Facilities Management
- ČSOB Penzijní společnost
- Hypoteční banka

*1) Decision of ČSOB's Board of Directors of 27 February 2018*

# FINANCIAL PART

# CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| Interest income | 5 | 25,979 | 25,043 |
| Interest expense | 6 | (3,287) | (2,808) |
| **Net interest income** | | **22,692** | **22,235** |
| Fee and commission income | | 10,126 | 9,577 |
| Fee and commission expense | | (3,730) | (3,359) |
| **Net fee and commission income** | 7 | **6,396** | **6,218** |
| Dividend income | | 11 | 8 |
| Net gains from financial instruments at fair value through profit or loss and foreign exchange | 8 | 5,825 | 3,147 |
| Net realised gains on available-for-sale financial assets | | 455 | 1,294 |
| Income from operating lease | 9 | 2,063 | 1,757 |
| Expense from operating lease | 9 | (1,709) | (1,452) |
| Other net income | 10 | 1,466 | 836 |
| **Operating income** | | **37,199** | **34,043** |
| Staff expenses | 11 | (7,920) | (7,510) |
| General administrative expenses | 12 | (6,952) | (6,873) |
| Depreciation and amortisation | 22, 23 | (1,380) | (1,268) |
| **Operating expenses** | | **(16,252)** | **(15,651)** |
| Impairment losses | 13 | (615) | (708) |
| Share of profit of associates and joint ventures | 20 | 637 | 696 |
| **Profit before tax** | | **20,969** | **18,380** |
| Income tax expense | 14 | (3,453) | (3,232) |
| **Profit for the year** | | **17,516** | **15,148** |
| **Attributable to:** | | | |
| Owners of the parent | | 17,517 | 15,141 |
| Non-controlling interests | | (1) | 7 |

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

CONSOLIDATED FINANCIAL STATEMENTS

# CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| **Profit for the year** | | **17,516** | **15,148** |
| Net loss on cash flow hedges | | (1,823) | (784) |
| Net loss on available-for-sale financial assets | | (616) | (2,080) |
| Share of other comprehensive income of associates and joint ventures | | (239) | (32) |
| Income tax benefit relating to components of other comprehensive income | | 463 | 545 |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | 31 | **(2,215)** | **(2,351)** |
| **Total comprehensive income for the year, net of tax** | | **15,301** | **12,797** |
| **Attributable to:** | | | |
| Owners of the parent | | 15,302 | 12,789 |
| Non-controlling interests | | (1) | 8 |

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

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash, balances with central banks and other demand deposits | 16 | 54,499 | 58,198 |
| Financial assets held for trading | 17 | 16,245 | 19,440 |
| Financial assets held for trading pledged as collateral | 17 | 2,097 | 568 |
| Available-for-sale financial assets | 18 | 29,482 | 53,861 |
| Available-for-sale financial assets pledged as collateral | 18 | 5,847 | 3,077 |
| Held-to-maturity investments | 18 | 86,604 | 116,626 |
| Held-to-maturity investments pledged as collateral | 18 | 29,017 | 16,053 |
| Loans and receivables | 19 | 1,062,201 | 782,099 |
| Fair value adjustments of the hedged items in portfolio hedge | | (4,298) | 852 |
| Derivatives used for hedging | 21 | 9,113 | 11,656 |
| Current tax assets | | 114 | 25 |
| Deferred tax assets | 14 | 245 | 179 |
| Investment in associates and joint ventures | 20 | 4,706 | 4,957 |
| Property and equipment | 22 | 11,024 | 10,009 |
| Goodwill and other intangible assets | 23 | 5,816 | 5,634 |
| Non-current assets held-for-sale | 24 | 42 | 52 |
| Other assets | 25 | 2,836 | 2,241 |
| **Total assets** | | **1,315,590** | **1,085,527** |
| **LIABILITIES AND EQUITY** | | | |
| Financial liabilities held for trading | 26 | 34,606 | 40,044 |
| Financial liabilities designated at fair value through profit or loss | 26 | 9,498 | 1,620 |
| Financial liabilities at amortised cost | 27 | 1,163,087 | 931,757 |
| Fair value adjustments of the hedged items in portfolio hedge | | (3,803) | 4,796 |
| Derivatives used for hedging | 21 | 10,485 | 10,532 |
| Current tax liabilities | | 386 | 849 |
| Deferred tax liabilities | 14 | 1,562 | 1,576 |
| Other liabilities | 28 | 5,152 | 4,945 |
| Provisions | 29 | 914 | 673 |
| **Total liabilities** | | **1,221,887** | **996,792** |
| Share capital | 30 | 5,855 | 5,855 |
| Share premium | | 20,929 | 20,929 |
| Statutory reserve | | 18,687 | 18,687 |
| Retained earnings | | 46,246 | 38,877 |
| Available-for-sale reserve | 30 | 1,490 | 2,228 |
| Cash flow hedge reserve | 30 | 496 | 1,973 |
| Shareholders' equity | | 93,703 | 88,549 |
| Non-controlling interests, presented within equity | | - | 186 |
| **Total equity** | | **93,703** | **88,735** |
| **Total liabilities and equity** | | **1,315,590** | **1,085,527** |

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

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2017

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

| (CZKm) | Attributable to equity holders of the parent: Share capital (Note: 30) | Share premium | Statutory reserve[1] | Retained earnings | Other reserves (Note: 30) | Non-controllin interest | Total Equity |
|---|---|---|---|---|---|---|---|
| **At 1 January 2016** | **5,855** | **20,929** | **18,687** | **38,517** | **6,553** | **178** | **90,719** |
| Profit for the year | - | - | - | 15,141 | - | 7 | 15,148 |
| Other comprehensive income for the year | - | - | - | - | (2,352) | 1 | (2,351) |
| Total comprehensive income for the year | - | - | - | 15,141 | (2,352) | 8 | 12,797 |
| Dividends paid (Note: 15) | - | - | - | (14,781) | - | - | (14,781) |
| **At 31 December 2016** | **5,855** | **20,929** | **18,687** | **38,877** | **4,201** | **186** | **88,735** |
| **At 1 January 2017** | **5,855** | **20,929** | **18,687** | **38,877** | **4,201** | **186** | **88,735** |
| Profit for the year | - | - | - | 17,517 | - | (1) | 17,516 |
| Other comprehensive income for the year | - | - | - | - | (2,215) | - | (2,215) |
| Total comprehensive income for the year | - | - | - | 17,517 | (2,215) | (1) | 15,301 |
| Dividends paid (Note: 15) | - | - | - | (10,147) | - | - | (10,147) |
| Changes in consolidation scope | - | - | - | (1) | - | (185) | (186) |
| **At 31 December 2017** | **5,855** | **20,929** | **18,687** | **46,246** | **1,986** | **-** | **93,703** |

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

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

These consolidated financial statements were approved for issue by the Board of Directors and signed on its behalf on 19 April 2018 by:

John Arthur Hollows
Chairman of the Board of Directors

Jiří Vévoda
Member of the Board of Directors

# CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| **Profit before tax** | | **20,969** | **18,380** |
| Adjustments for: | | | |
| Interest income | 5 | (25,979) | (25,043) |
| Interest expense | 6 | 3,287 | 2,808 |
| Dividend income (other than from associates and joint ventures) | | (11) | (8) |
| Non-cash items included in profit before tax | 33 | (192) | 2,435 |
| Net gains from investing activities | | (108) | (39) |
| **Cash flow used in operations before changes in operating assets, liabilities, income tax paid, interest paid and received and dividend received** | | **(2,034)** | **(1,467)** |
| Change in operating assets | 33 | (18,651) | (30,889) |
| Change in operating liabilities | 33 | 101,036 | 73,087 |
| Income tax paid | | (3,606) | (2,409) |
| Interest paid | | (3,674) | (3,366) |
| Interest received | | 27,629 | 26,669 |
| Dividend received (other than from associates and joint ventures) | | 11 | 8 |
| **Net cash flows from operating activities** | | **100,711** | **61,633** |
| **INVESTING ACTIVITIES** | | | |
| Purchase of held-to-maturity investments | | (573) | (4,848) |
| Maturity / disposal of investment securities | | 15,739 | 7,901 |
| Purchase of property, equipment and intangible assets | | (5,603) | (6,065) |
| Proceeds from disposal of property, equipment, intangible assets and assets held-for-sale | | 2,299 | 2,044 |
| Dividends from associates and joint ventures | | 649 | 677 |
| Changes in consolidation scope | | (187) | - |
| Reintegration of information and communication services | | - | (955) |
| **Net cash flows from / (used in) investing activities** | | **12,324** | **(1,246)** |
| **FINANCING ACTIVITIES** | | | |
| Repayment of bonds | | (7,719) | (2,700) |
| Issue of bonds | | - | 3,037 |
| Dividends paid | 15 | (10,147) | (14,781) |
| **Net cash flows used in financing activities** | | **(17,866)** | **(14,444)** |
| **Net increase in cash and cash equivalents** | | **95,169** | **45,943** |
| Cash and cash equivalents at the beginning of the year | 33 | 90,313 | 44,370 |
| Net increase in cash and cash equivalents | | 95,169 | 45,943 |
| **Cash and cash equivalents at the end of the year** | 33 | **185,482** | **90,313** |

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

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

## 1. CORPORATE INFORMATION

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

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

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

## 2. ACCOUNTING POLICIES

### *2.1 Basis of preparation*

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

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

The consolidated financial statements are presented in millions of Czech Crowns (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 Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The Group controls an investee if, and only if, the Group has:

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

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

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

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

## *2.2 Significant accounting judgements and estimates*

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

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

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

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

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

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

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

**Goodwill impairment (Note: 23)**

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

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

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

### *2.3 Changes in accounting policies*

**Effective from 1 January 2017**

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

**Disclosure Initiative (Amendment to IAS 7)** is effective for periods on or after 1 January 2017. The amendment requires that the following changes in liabilities arising from financing activities are disclosed: (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

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

**Effective after 1 January 2017**

The following standards, amendments and interpretations have been issued and are effective after 1 January 2017. The Group has decided not to early adopt them. Unless otherwise described below, the new standards, amendments and interpretations are not expected to significantly affect the Group financial statements.

**IFRS 9 Financial Instruments (2014)** is effective for periods beginning on or after 1 January 2018. The implementation is structured along two pillars: namely classification & measurement and impairment, as well as a common work stream relating to the impact on reporting and disclosures.

**Classification and measurement of financial instruments**

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

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

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

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

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

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

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

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

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

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

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

For financial liabilities, IFRS 9 changes the presentation of gains and losses on own credit risk for financial instruments designated at fair value through profit or loss. The Group early adopts this aspect of IFRS 9 with effect from 1 January 2017 and the gains and losses on own credit risk go through other comprehensive income. The impact of early adoption is zero given the limited effect of own credit risk.

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

**Impairment of financial assets**

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

Stage 1 (or Performing) includes financial instruments with credit risk that has not increased significantly since initial recognition. 12-month expected credit losses are recognised for these assets. Interest income is based on the gross carrying amount of the assets.

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

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

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

The Group has established policies and processes to assess whether credit risk has increased significantly at the end of each reporting period and, therefore, "staging" is required (i.e. moving from one stage to another). For the loan portfolio, a multi-tier approach has been adopted to staging, based on internal credit ratings, forbearance measures, collective assessment and days past due as a backstop. A similar multi-tier approach will be used for the investment portfolio except that the Group intends to use the low-credit-risk exemption, meaning that all bonds in scope with a PD of 1 to 3 are considered to be in Stage 1, unless any of the other triggers indicate otherwise.

For Stage 1 and Stage 2 - under IAS 39 - the Group records incurred-but-not-reported (IBNR) impairment losses, which are influenced by emergence periods. Under IFRS 9, impairment of financial assets is calculated on a 12-month expected credit loss (ECL) basis for Stage 1 and on a lifetime ECL basis for Stage 2.  As a consequence, impairment levels are generally expected to increase. Forward looking information is incorporated into the staging criteria and measurement of ECL. Different macroeconomic factors are taken into consideration and the Group applies three scenarios to evaluate a range of possible outcomes. The impact of first time application has been positively influenced by the current benign macroeconomic environment. Impairment levels under current prudential requirements will differ from IFRS 9 because of (i) application of a through-the-cycle estimate for prudential purposes as opposed to a point-in-time estimate under IFRS 9, (ii) application of a 12-month PD for prudential purposes as opposed to a lifetime PD under IFRS 9 (for 'Stage 2' and 'Stage 3'), (iii) inclusion of prudential floors and downturn adjustments in the PD, EAD and LGD estimates for prudential purposes and iv) inclusion of macroeconomic parameters under IFRS 9.

The first time application of IFRS 9 led to a drop of the Group’s total capital ratio by 5 basis points. A combined negative effect of reclassification of a part of the Treasury bond portfolio and an initial ECL recognition was compensated by reduction of IRB shortfall.

**Hedge accounting**

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

**Prepayment Features with Negative Compensation (Amendments to IFRS 9)** is effective for periods beginning on or after 1 January 2019. The amendment clarifies that financial assets with contractual cash flows that are solely payments of principal and interest and prepayment features that may result in reasonable negative compensation for the early termination of the contract are eligible to be measured at amortised cost or at fair value through other comprehensive income.

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

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

1. Identify the contract with the customer (a contract exists only when it is ‘probable’ that the entity will collect the consideration);

2. Identify separate Performance Obligations in the contract (a promise to transfer good or service);

3. Determine the transaction price (only an amount not subject to subsequent future reversals);

4. Allocate the transaction price to each Performance Obligation;

5. Recognise revenue when or as each Performance Obligation is satisfied.

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

**IFRS 16 Leases** is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer (‘lessee’) and the supplier (‘lessor’). The new standard requires lessees to recognize most leases in their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The Group is currently assessing the impact that IFRS 16 will have on the financial statements.

**IFRS 17 Insurance Contracts** is effective for annual periods beginning on or after 1 January 2021 and has not yet been endorsed by the EU. The standard establishes principles for the recognition, measurement, presentation and disclosure of issued insurance and held reinsurance contracts, life and non-life. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued.

**Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)** is effective for annual periods beginning on or after 1 January 2018. The amendment permits insurers that meet specified criteria to apply a temporary exemption from IFRS 9. Further it permits insurers to apply the overlay approach to designated financial assets and to reclassify in specified circumstances some or all of their financial assets so that the assets are measured at fair value through profit or loss.

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

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

**Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)** is effective for periods on or after 1 January 2019. The amendment clarifies that any long-term interests in an associate or joint venture that, in substance, form a part of the entity´s net investment are in scope of IFRS 9.

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

**IFRIC 23 Uncertainty over Income Tax Treatments** is effective for periods on or after 1 January 2019. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatment.

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

**Annual Improvements to IFRS Standards (2015 - 2017 Cycle)**, issued in December 2017 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard, all of which are applicable on or after 1 January 2019.

## *2.4 Summary of significant accounting policies*

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

### (1) Foreign currency translation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- *Derivatives held for trading*

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

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

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

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

- *Financial instruments held for trading other than derivatives*

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

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

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

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

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

*(ii) Held-to-maturity investments*

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

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

*(iii) Loans and receivables*

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

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

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

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

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

*(v) Financial liabilities at amortised cost*

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

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

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

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

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

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

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

**(5) Determination of fair value**

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

**(6) Impairment of financial assets**

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

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

*(i) Assets carried at amortised cost*

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

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

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

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

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

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

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

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

*(ii) Renegotiated loans*

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

*(iii) Financial assets carried at fair value*

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

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

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

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

### (8) Hedge accounting

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

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

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

*(i) Cash flow hedges*

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

*(ii) Fair value hedges*

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

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

**(9) Offsetting financial instruments**

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

**(10) Reclassification of financial assets**

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

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

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

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

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

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

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

**(11) Leasing**

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

*(i) Group company as a lessee*

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

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

*(ii) Group company as a lessor*

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

Leases, in which the Group does not transfer substantially, all the risks and benefits of ownership of the asset, are classified as operating leases. The Group leases out certain of its properties under operating leases, thus generating rental income. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned. Rental income, as well as depreciation and other expenses relating to operating lease assets are reported separately in the consolidated statement of income under Income or Expense from operating lease.

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

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

*(i) Interest income and expense*

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

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

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

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

*(ii) Fee and commission income*

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

*(iii) Dividend income*

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

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

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

**(13) Cash and cash equivalents**

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

**(14) Investments in associates and joint ventures**

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

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

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

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

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

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

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

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

**(15) 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.

**(16) Business combinations and goodwill**

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

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

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

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

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

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

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

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

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

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

**(17) Intangible assets**

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

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

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

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

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

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

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

**(18) Financial guarantees**

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

**(19) 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.

**(20) 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.

**(21) Income tax**

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

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

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

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

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

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

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

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

The 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.

**(22) Share capital and reserves**

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

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

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

**(23) Fiduciary activities**

The 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.

**(24) 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.

## 2.5 Comparative balances

### Reclassification

In 2017, the ČSOB group and the KBC Group have decided to change presentation of some items within the structure of the consolidated financial statements consistently with the rules of the Unified Framework of the Consolidated Financial Reporting (FINREP). As a result, demand deposits in other credit institutions measured at amortised cost have been reclassified from the Loans and receivables to the Cash, balances with central banks and other demand deposits. Such a reclassification did not impact the statement of cash flows since these demand deposits were already included in the balance of cash equivalents before the reclassification.

Furthermore, ČSOB group decided to change presentation of debt securities pledged as collateral in repo transactions or securities lending in 2017. The Group shifted these pledged assets from the original captions to the separate lines in the consolidated statement of financial position, so that the pledged assets are not mixed together with other financial assets on the position of the Group.

In the consolidated statement of income, ČSOB group separated net income resulted from the operating lease activities. Formerly, these items were presented as part of Other net income. In 2017, two new separate items relating to income and expense from operating leases, in which the Group is in the position of lessor, were added to the statement of income.

In 2017, the Group changed the presentation of interest received, interest paid and dividends received in the consolidated statement of cash flows. These items, previously reported within a separate table below the statement, have been incorporated into the statement of cash flows as part of the net cash flows from operating activities.

Such a presentation provides more reliable and more relevant information about the nature of the assets, income, expense and cash flows including an increase of comparability among different reporters on the market. To conform to the change in presentation in the current year, certain items in the comparative balances have been reclassified.

A reconciliation of the selected items of the consolidated statement of income for the year ended 31 December 2016 is provided below:

| (CZKm) | 2016 As reported | Reclassification of operating leases | 2016 Reclassified |
|---|---|---|---|
| Income from operating lease | - | 1,757 | 1,757 |
| Expense from operating lease | - | (1,452) | (1,452) |
| Other net income | 1,141 | (305) | 836 |

A reconciliation of the selected items of the consolidated statement of financial position as at 31 December 2016 is provided below:

| (CZKm) | 2016 As reported | Reclassification of demand deposits | Reclassification of pledged assets | 2016 Reclassified |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash, balances with central banks and other demand deposits | 57,074 | 1,124 | | 58,198 |
| Financial assets held for trading | 20,008 | | (568) | 19,440 |
| Financial assets held for trading pledged as collateral | - | | 568 | 568 |
| Available-for-sale financial assets | 56,938 | | (3,077) | 53,861 |
| Available-for-sale financial assets pledged as collateral | - | | 3,077 | 3,077 |
| Held-to-maturity investments | 132,679 | | (16,053) | 116,626 |
| Held-to-maturity investments pledged as collateral | - | | 16,053 | 16,053 |
| Loans and receivables | 783,223 | (1,124) | | 782,099 |

A reconciliation of the selected items of the consolidated statement of financial position as at 1 January 2016 is provided below:

| (CZKm) | 31 December 2015 As reported | Reclassification of demand deposits | Reclassification of pledged assets | 1 January 2016 Reclassified |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash, balances with central banks and other demand deposits | 117,287 | 1,117 | | 118,404 |
| Available-for-sale financial assets | 59,961 | | (1,056) | 58,905 |
| Available-for-sale financial assets pledged as collateral | - | | 1,056 | 1,056 |
| Held-to-maturity investments | 136,433 | | (2,433) | 134,000 |
| Held-to-maturity investments pledged as collateral | - | | 2,433 | 2,433 |
| Loans and receivables | 579,448 | (1,117) | | 578,331 |

## 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 | % 2017 | % 2016 |
|---|---|---|---|---|
| **Subsidiaries** | | | | |
| Bankovní informační technologie, s.r.o. | BANIT | Czech Republic | 100.00 | 100.00 |
| Centrum Radlická a.s. | Centrum Radlická | Czech Republic | - | 100.00 |
| ČSOB Advisory, a.s. | ČSOB Advisory | Czech Republic | 100.00 | 100.00 |
| ČSOB Factoring, a.s. | ČSOB Factoring | Czech Republic | 100.00 | 100.00 |
| ČSOB Leasing, a.s. | ČSOB Leasing | Czech Republic | 100.00 | 100.00 |
| ČSOB Leasing pojišťovací makléř, s.r.o. | ČSOB Leasing pojišťovací makléř | Czech Republic | 100.00 | 100.00 |
| ČSOB Penzijní společnost, a. s., a member of the ČSOB group | ČSOB PS | Czech Republic | 100.00 | 100.00 |
| ČSOB Property fund, a.s. | ČSOB Property fund | Czech Republic | - | 61.61 |
| Hypoteční banka, a.s. | Hypoteční banka | Czech Republic | 100.00 | 100.00 |
| Merrion Properties s.r.o. | Merrion Properties | Czech Republic | - | 61.61 |
| Patria Corporate Finance, a.s. | Patria CF | Czech Republic | 100.00 | 100.00 |
| Patria Finance, a.s. | Patria Finance | Czech Republic | 100.00 | 100.00 |
| Patria Online, a.s. | Patria Online | Czech Republic | - | 100.00 |
| Radlice Rozvojová, a.s. | Radlice Rozvojová | Czech Republic | 100.00 | 100.00 |
| **Joint venture** | | | | |
| Českomoravská stavební spořitelna, a.s. | ČMSS | Czech Republic | 55.00 | 55.00 |
| **Associates** | | | | |
| ČSOB Asset Management, a.s., investment company | ČSOB AM | Czech Republic | 40.08 | 40.08 |
| ČSOB Pojišťovna, a.s., a member of the ČSOB holding | ČSOB Pojišťovna | Czech Republic | 0.24 | 0.24 |

On 17 May 2017, the management of the Bank decided to merge the Bank with its subsidiaries Centrum Radlická and Patria Online, ČSOB being the successor company, resulting in the simplification of the consolidation scope of the Group. The merger was subject to the Czech National Bank approval and was finalised on 1 December 2017.

Based on the Agreement on the exercise of voting rights, the Group is entitled to a total of 40% of the voting rights in ČSOB Pojišťovna. Thus, ČSOB Pojišťovna is still assessed to be an associated company of the Bank (Note: 20).

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

In 2017, the Bank liquidated its subsidiaries ČSOB Property Fund and Merrion Properties as a result of the earlier decision of the management of the Group to terminate its real estate activities.

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

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

## 4. SEGMENT INFORMATION

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

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

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

**Definitions of customer operating segments:**

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

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

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

**Specialised banking:** This segment contains mortgages, building savings and building savings loans.

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

In 2017, the Group‘s segment reporting was modified following the change of the organisational structure of the Group. Thus, Asset Management and Penzijní společnost are managed in the same way as retail clients and were moved from strategic business unit Specialised banking to Retail in 2017. Furthermore, a part of other operating expenses (Facility management, IT), previously allocated into segments, started to be reported at Group Centre in 2017. Comparative figures in the Consolidated statement of income for 2016 have been reclassified.

### Segment reporting information by customer segments for 2017

| (CZKm) | Retail | Relationship services | Financial markets | Specialised banking | Group Centre | Total |
|---|---|---|---|---|---|---|
| ***Statement of income*** | | | | | | |
| Net interest income | 7,086 | 8,743 | 341 | 4,483 | 2,039 | **22,692** |
| Net fee and commission income | 2,211 | 2,747 | 508 | 559 | 371 | **6,396** |
| Dividend income | - | - | 2 | - | 9 | **11** |
| Net gains from financial instruments at fair value through profit or loss | 606 | 1,898 | 2,584 | (74) | 811 | **5,825** |
| Net realised gains on available-for-sale financial assets | - | - | - | - | 455 | **455** |
| Income from operating lease | - | 2,063 | - | - | - | **2,063** |
| Expense from operating lease | - | (1,709) | - | - | - | **(1,709)** |
| Other net income | 37 | 106 | 7 | 16 | 1,300 | **1,466** |
| **Operating income** | **9,940** | **13,848** | **3,442** | **4,984** | **4,985** | **37,199** |
| *of which:* | | | | | | |
| *External operating income* | *4,802* | *11,688* | *3,442* | *6,744* | *10,523* | *37,199* |
| *Intersegment operating income* | *5,138* | *2,160* | *-* | *(1,760)* | *(5,538)* | *-* |
| Depreciation and amortisation | (38) | (60) | (16) | (62) | (1,204) | **(1,380)** |
| Other operating expenses | (6,779) | (4,341) | (415) | (919) | (2,418) | **(14,872)** |
| **Operating expenses** | **(6,817)** | **(4,401)** | **(431)** | **(981)** | **(3,622)** | **(16,252)** |
| Impairment losses - additions | (524) | (2,234) | - | (464) | (191) | **(3,413)** |
| Impairment losses - reversals | 659 | 1,649 | - | 485 | 5 | **2,798** |
| **Impairment losses** | **135** | **(585)** | **-** | **21** | **(186)** | **(615)** |
| Share of profit of associates and joint ventures | 77 | - | - | 560 | - | **637** |
| **Profit before tax** | **3,335** | **8,862** | **3,011** | **4,584** | **1,177** | **20,969** |
| Income tax expense | (650) | (1,682) | (573) | (754) | 206 | **(3,453)** |
| **Segment profit** | **2,685** | **7,180** | **2,438** | **3,830** | **1,383** | **17,516** |
| **Attributable to:** | | | | | | |
| Owners of the parent | 2,685 | 7,180 | 2,438 | 3,830 | 1,384 | **17,517** |
| Non-controlling interest | - | - | - | - | (1) | **(1)** |
| ***Assets and liabilities*** | | | | | | |
| Segment assets | 28,588 | 288,685 | 47,516 | 280,341 | 665,712 | **1,310,842** |
| Investment in associates and joint ventures | - | - | - | - | 4,706 | **4,706** |
| Non-current assets held-for-sale | - | 42 | - | - | - | **42** |
| **Total assets** | **28,588** | **288,727** | **47,516** | **280,341** | **670,418** | **1,315,590** |
| **Total liabilities** | **388,355** | **398,764** | **47,928** | **13,775** | **373,065** | **1,221,887** |
| **Capital expenditure** | **349** | **2,734** | **26** | **154** | **2,262** | **5,525** |

## Segment reporting information by customer segments for 2016

| (CZKm) | Retail | Relationship services | Financial markets | Specialised banking | Group Centre | Total |
|---|---|---|---|---|---|---|
| ***Statement of income*** | | | | | | |
| Net interest income | 7,334 | 8,384 | (15) | 4,828 | 1,704 | **22,235** |
| Net fee and commission income | 2,354 | 2,525 | 528 | 522 | 289 | **6,218** |
| Dividend income | - | - | 1 | - | 7 | **8** |
| Net gains from financial instruments at fair value through profit or loss | 516 | 1,519 | 941 | - | 171 | **3,147** |
| Net realised gains on available-for-sale financial assets | - | (1) | - | - | 1,295 | **1,294** |
| Income from operating lease | - | 1,757 | - | - | - | **1,757** |
| Expense from operating lease | - | (1,452) | - | - | - | **(1,452)** |
| Other net income | 38 | 199 | 9 | 41 | 549 | **836** |
| **Operating income** | **10,242** | **12,931** | **1,464** | **5,391** | **4,015** | **34,043** |
| *of which:* | | | | | | |
| *External operating income* | *4,657* | *11,081* | *1,464* | *7,068* | *9,773* | *34,043* |
| *Intersegment operating income* | *5,585* | *1,850* | *-* | *(1,677)* | *(5,758)* | *-* |
| Depreciation and amortisation | (52) | (37) | (10) | (82) | (1,087) | **(1,268)** |
| Other operating expenses | (6,575) | (4,258) | (437) | (987) | (2,126) | **(14,383)** |
| **Operating expenses** | **(6,627)** | **(4,295)** | **(447)** | **(1,069)** | **(3,213)** | **(15,651)** |
| Impairment losses - additions | (363) | (1,893) | (2) | (590) | (456) | **(3,304)** |
| Impairment losses - reversals | 450 | 1,223 | - | 543 | 380 | **2,596** |
| **Impairment losses** | **87** | **(670)** | **(2)** | **(47)** | **(76)** | **(708)** |
| Share of profit of associates and joint ventures | 64 | - | - | 632 | - | **696** |
| **Profit before tax** | **3,766** | **7,966** | **1,015** | **4,907** | **726** | **18,380** |
| Income tax expense | (704) | (1,525) | (192) | (802) | (9) | **(3,232)** |
| **Segment profit** | **3,062** | **6,441** | **823** | **4,105** | **717** | **15,148** |
| **Attributable to:** | | | | | | |
| Owners of the parent | 3,062 | 6,441 | 823 | 4,105 | 710 | **15,141** |
| Non-controlling interest | - | - | - | - | 7 | **7** |
| ***Assets and liabilities*** | | | | | | |
| Segment assets | 24,652 | 277,382 | 22,590 | 255,519 | 500,375 | **1,080,518** |
| Investment in associates and joint ventures | - | - | - | - | 4,957 | **4,957** |
| Non-current assets held-for-sale | - | 17 | - | - | 35 | **52** |
| **Total assets** | **24,652** | **277,399** | **22,590** | **255,519** | **505,367** | **1,085,527** |
| **Total liabilities** | **365,226** | **320,901** | **42,002** | **21,341** | **247,323** | **996,792** |
| **Capital expenditure** | **294** | **4,016** | **53** | **191** | **1,439** | **5,993** |

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) | 2017 | 2016 |
|---|---|---|
| Cash, balances with central banks and other demand deposits | 88 | 53 |
| Loans and receivables | | |
| Credit institutions | 1,456 | 364 |
| Other than credit institutions | 15,138 | 15,359 |
| Available-for-sale financial assets, incl. assets pledged as collateral | 1,341 | 1,486 |
| Held-to-maturity investments, incl. assets pledged as collateral | 4,428 | 5,091 |
| Financial assets held for trading, incl. assets pledged as collateral (Note: 8) | 225 | 334 |
| Derivatives used as economic hedges (Note: 8) | 200 | 128 |
| Derivatives used for hedging (Note: 8) | 1,905 | 1,854 |
| Negative interest from financial liabilities measured at amortised cost | 1,183 | 349 |
| Negative interest from financial liabilities measured at fair value (Note: 8) | 15 | 25 |
| | **25,979** | **25,043** |

## 6. INTEREST EXPENSE

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Financial liabilities at amortised cost | | |
| Central banks | 3 | - |
| Credit institutions | 540 | 206 |
| Other than credit institutions | 795 | 714 |
| Debt instruments in issue | 328 | 342 |
| Discount amortisation on other provisions (Note: 29) | 3 | 3 |
| Financial liabilities held for trading (Note: 8) | 447 | 413 |
| Financial liabilities designated at fair value through profit or loss (Note: 8) | 43 | - |
| Derivatives used as economic hedges (Note: 8) | 140 | 76 |
| Derivatives used for hedging (Note: 8) | 981 | 1,050 |
| Negative interest from financial assets measured at fair value (Note: 8) | 7 | 4 |
| | **3,287** | **2,808** |

## 7. NET FEE AND COMMISSION INCOME

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Fee and commission income** | | |
| Payment services | 5,438 | 5,274 |
| Administration of credits | 1,985 | 1,954 |
| Collective investments | 823 | 664 |
| Securities | 270 | 374 |
| Custody | 202 | 185 |
| Asset management | 36 | 79 |
| Other | 1,372 | 1,047 |
| | **10,126** | **9,577** |
| **Fee and commission expense** | | |
| Payment services | 1,868 | 1,479 |
| Retail service fees | 963 | 1,017 |
| Commissions to agents | 125 | 126 |
| Other | 774 | 737 |
| | **3,730** | **3,359** |
| **Net fee and commission income** | **6,396** | **6,218** |

## 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) | 2017 | 2016 |
|---|---|---|
| **Net gains from financial instruments at fair value through profit or loss and foreign exchange- as reported** | **5,825** | **3,147** |
| Net interest income (Notes: 5, 6) | 727 | 798 |
| | **6,552** | **3,945** |
| **Financial instruments held for trading and derivatives used for hedging** | | |
| Interest rate contracts | 958 | 1,290 |
| Foreign exchange | 11,706 | 849 |
| Equity contracts | 352 | 173 |
| Commodity contracts | 10 | 15 |
| | 13,026 | 2,327 |
| **Financial instruments designated at fair value through profit or loss** | | |
| Financial assets designated at fair value through profit or loss | - | 5 |
| Financial liabilities designated at fair value through profit or loss | 22 | (73) |
| | 22 | (68) |
| Foreign exchange differences | (6,496) | 1,686 |
| **Financial instruments at fair value through profit or loss and foreign exchange** | **6,552** | **3,945** |

## 9. NET RESULT FROM OPERATING LEASE

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Income from operating lease** | | |
| Revenues from operating leases | 992 | 779 |
| Revenues from disposal of assets under operating leases | 857 | 926 |
| Revenues from other services relating to operating leases | 214 | 52 |
| | **2,063** | **1,757** |
| **Expense from operating lease** | | |
| Depreciation of assets under operating leases | (420) | (356) |
| Expenses from disposal of assets under operating leases | (861) | (744) |
| Other services relating to operating leases | (428) | (352) |
| | **(1,709)** | **(1,452)** |

## 10. OTHER NET INCOME

| (CZKm) | 2017 | 2016 |
|---|---|---|
| ICT services | 606 | 551 |
| Services provided to the parent and to entities under common control (excluding income from ICT services) | 148 | 125 |
| Net gain on disposal of Held-to-maturity investments | 126 | 2 |
| Other services provided by ČSOB Leasing | 49 | 56 |
| Net gain on disposal of loans and receivables | 2 | 1 |
| Net increase in provisions for legal issues and other losses | (9) | (72) |
| Net loss on disposal of intangible assets | (10) | - |
| Net loss on disposal of property and equipment | (11) | (9) |
| Other | 565 | 182 |
| | **1,466** | **836** |

## 11. STAFF EXPENSES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Wages and salaries | 5,679 | 5,327 |
| Salaries and other short-term benefits of top management | 91 | 90 |
| Social security charges | 1,876 | 1,776 |
| *of which pension security charges (obligatory)* | *1,149* | *1,073* |
| Pension (voluntary) and similar expenses | 139 | 133 |
| Other | 135 | 184 |
| | **7,920** | **7,510** |

### Number of personnel of the Group

The number (in full-time equivalents) of personnel of the Group was 8,299 at 31 December 2017 (31 December 2016: 8,232).

### Management bonus scheme

Included within Salaries and other short-term benefits of top management are base salaries, annual bonuses and other short-term benefits 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.

A bonus scheme of the Group follows the changes in legislation in previous years. Half of the bonus is provided in a non-cash instrument, so called 'Virtual investment certificate' (VIC). VIC is linked to the Economic Value Added of the Group which captures both finance and risk aspects. Another half of the bonus is paid in cash. The payment of half of the bonus (both cash and non-cash portion) is deferred for up to the next five years following the initial assignment of the benefit.

### Retirement benefits

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

### Termination benefits

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

In the case of contract termination, the members of the Board of Directors are entitled to receive an amount of 0 to 12 monthly salaries as termination benefits (according to conditions of individual contracts). In 2017 and 2016, no such compensation was paid.

## 12. GENERAL ADMINISTRATIVE EXPENSES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Information technologies | 2,379 | 2,244 |
| Marketing | 661 | 645 |
| Rental expenses on land and buildings - minimum lease payments | 554 | 571 |
| Contribution to the Single Resolution Mechanism | 546 | 603 |
| Professional fees | 485 | 498 |
| Other building expenses | 467 | 469 |
| Communication | 395 | 370 |
| Retail service fees | 232 | 198 |
| Administration | 215 | 223 |
| Payment cards and electronic banking | 211 | 152 |
| Deposit insurance premium and contribution to the Securities Traders Guarantee Fund | 181 | 163 |
| Travel and transportation | 174 | 151 |
| Training | 88 | 78 |
| Insurance | 41 | 36 |
| Car expenses | 26 | 21 |
| Other | 297 | 451 |
| | **6,952** | **6,873** |

## 13. IMPAIRMENT LOSSES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Impairment of loans and receivables (Notes: 33, 40.2) | 106 | (670) |
| Provisions for loan commitments and guarantees (Notes: 29, 33) | (237) | 53 |
| Impairment of property, plant and equipment (Notes: 22, 33) | (140) | (13) |
| Impairment of available-for-sale financial assets (Notes: 18, 33) | (26) | (2) |
| Impairment of held-to-maturity investments (18, 33) | (2) | - |
| Impairment of intangible assets (Note: 23, 33) | (189) | (74) |
| Impairment of non-current assets held-for-sale (Note: 24, 33) | 9 | - |
| Impairment of other assets (Note: 33) | (136) | (2) |
| | **(615)** | **(708)** |

## 14. INCOME TAX

The components of income tax expense for the years ended 31 December 2017 and 2016 are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Current tax expense | 3,062 | 3,167 |
| Net provisions for tax disputes | 7 | 149 |
| Previous year over accrual of current tax | (7) | (9) |
| Deferred tax expense / (benefit) relating to the origination and reversal of temporary differences | 391 | (75) |
| | **3,453** | **3,232** |

A reconciliation between the tax expense and the accounting profit multiplied by the domestic tax rate for the years ended 31 December 2017 and 2016 is as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Profit before taxation | 20,969 | 18,380 |
| Applicable tax rates | 19% | 19% |
| Taxation at applicable tax rates | 3,984 | 3,492 |
| Net provisions for tax disputes | 7 | 149 |
| Previous year over accrual of current tax | (7) | (9) |
| Tax effect of non-taxable income | (792) | (809) |
| Tax effect of non-deductible expenses | 271 | 443 |
| Unused tax losses applicable in next periods | (10) | (34) |
| | **3,453** | **3,232** |

The applicable tax rate for 2017 was 19% (2016: 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) | 2017 | 2016 |
|---|---|---|
| **At 1 January** | **(1,397)** | **(2,010)** |
| Statement of income | (391) | 75 |
| Available-for-sale securities (Note: 31) | | |
| Fair value remeasurement | 4 | 111 |
| Transfer to net profit | 113 | 285 |
| Cash-flow hedges (Note: 31) | | |
| Fair value remeasurement | 190 | 29 |
| Transfer to net profit (Note: 21) | 156 | 120 |
| Other | 8 | (7) |
| **At 31 December** | **(1,317)** | **(1,397)** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Deferred tax asset** | | |
| Temporary difference resulting from tax depreciation | 290 | 65 |
| Employee benefits | 258 | 7 |
| Initial fee income | 208 | 21 |
| Provisions | 135 | 2 |
| Temporary difference resulting from tax depreciation related to acquisition of ICT function | 124 | - |
| Legal claims | 124 | - |
| Allowances for credit losses | 48 | 46 |
| Impairment of tangible and intangible assets | 45 | 5 |
| Impairment losses on financial investments | 26 | - |
| Unused tax losses applicable in the next periods | 7 | 31 |
| Held-to-maturity investments - bonds reclassified from Available-for-sale assets (Note: 18) | (45) | - |
| Revaluation of financial assets and liabilities at fair value through profit or loss | (76) | - |
| Cash-flow hedging derivatives | (123) | - |
| Available-for-sale securities | (275) | - |
| Amortisation of goodwill | (511) | - |
| Other temporary differences | 10 | 2 |
| | **245** | **179** |

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Deferred tax liability** | | |
| Temporary difference resulting from tax depreciation | 761 | 682 |
| Initial fee expense | 451 | 204 |
| Revaluation of financial assets and liabilities at fair value through profit or loss | 187 | (41) |
| Available-for-sale securities | 179 | 545 |
| Cash-flow hedging derivatives | 70 | 540 |
| Finance lease valuation | 39 | 86 |
| Amortisation of goodwill | - | 478 |
| Held-to-maturity investments – bonds reclassified from Available-for-sale assets (Note: 18) | - | 72 |
| Impairment of tangible and intangible assets | - | (17) |
| Impairment losses on financial investments | - | (26) |
| Temporary difference resulting from tax depreciation related to acquisition of ICT function | - | (134) |
| Legal claims | - | (202) |
| Provisions | (12) | (110) |
| Allowances for credit losses | (32) | (168) |
| Employee benefits | (69) | (265) |
| Other temporary differences | (12) | (68) |
| | **1,562** | **1,576** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Temporary difference resulting from tax depreciation | 146 | (20) |
| Employee benefits | 55 | (15) |
| Initial fee income | (60) | (84) |
| Available-for-sale securities | (11) | 8 |
| Finance lease valuation | 47 | (11) |
| Provisions | 35 | (2) |
| Amortisation of goodwill | (33) | (36) |
| Revaluation of financial assets and liabilities at fair value through profit or loss | (304) | 24 |
| Allowances for credit losses | (134) | 38 |
| Legal claims | (78) | 109 |
| Unused tax losses applicable in the next periods | (23) | 9 |
| Impairment of tangible and intangible assets | 28 | 16 |
| Temporary difference resulting from tax depreciation related to acquisition of ICT function | (10) | (10) |
| Other temporary differences | (49) | 49 |
| | **(391)** | **75** |

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.

## 15. 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 2017 has not been taken before the date of issue of the financial statements.

Based on a sole shareholder decision from 27 April 2017, a dividend of CZK 34.66 per share was paid for 2016, representing a total dividend of CZK 10,147 m.

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

## 16. CASH, BALANCES WITH CENTRAL BANKS AND OTHER DEMAND DEPOSITS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Cash (Note: 33) | 9,745 | 9,077 |
| Mandatory minimum reserves (Notes: 33, 34, 40.2) | 12,831 | 10,782 |
| Other balances with central banks (Notes: 33, 34, 40.2) | 30,435 | 37,215 |
| Other demand deposits in credit institutions (Notes: 33, 34, 40.2) | 1,488 | 1,124 |
| | **54,499** | **58,198** |

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

Other balances with central banks contain overnight loans provided to central bank in the amount of CZK 27,250 m at 31 December 2017 (31 December 2016: CZK 33,900 m).

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Financial assets held for trading** | | |
| Loans and advances | | |
| Reverse repo transactions (Note: 36) | 39 | 155 |
| Money market placements | - | 15 |
| Debt instruments | | |
| General government | 1,047 | 3,959 |
| Credit institutions | 2,263 | 2,446 |
| Corporate | 430 | 247 |
| Equity securities | | |
| Corporate | 9 | 1 |
| Derivative contracts (Note: 21) | | |
| Trading derivatives | 12,224 | 12,167 |
| Derivatives used as economic hedges | 233 | 450 |
| | **16,245** | **19,440** |
| **Financial assets held for trading pledged as collateral** | | |
| Debt instruments | | |
| General government | 2,097 | 568 |
| | **2,097** | **568** |
| **Financial assets at fair value through profit or loss** | **18,342** | **20,008** |

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

## 18. FINANCIAL INVESTMENTS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Available-for-sale financial assets** | | |
| Debt securities | | |
| General government | 27,357 | 38,576 |
| Credit institutions | 1,248 | 14,442 |
| Corporate | 417 | 427 |
| Equity securities | | |
| Corporate | 460 | 416 |
| | **29,482** | **53,861** |
| **Available-for-sale financial assets pledged as collateral** | | |
| Debt securities | | |
| General government | 3,893 | 1,009 |
| Credit institutions | 1,954 | 2,068 |
| | **5,847** | **3,077** |
| **Held-to-maturity investments** | | |
| Debt securities | | |
| General government | 84,453 | 114,400 |
| Credit institutions | 1,317 | 1,393 |
| Corporate | 834 | 833 |
| | **86,604** | **116,626** |
| **Held-to-maturity investments pledged as collateral** | | |
| Debt securities | | |
| General government | 29,017 | 16,053 |
| | **29,017** | **16,053** |
| **Financial investments** | **150,950** | **189,617** |

Included within Financial investments pledged as collateral are debt securities pledged as collateral in repo transactions in the amount of CZK 21,303 m (2016: CZK 9,578) or securities lending in the amount of CZK 13,561 m (2016: CZK 9,552 m). Under the terms and conditions of the pledge in repo transactions or securities lending, the transferee has a right to sell or repledge the collateral.

Included in Financial investments, there are debt securities of CZK 15,514 m (2016: CZK 12,601 m) pledged as collateral of term deposits and financial guarantees.

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

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Carrying value | 6,268 | 8,552 |
| Fair value | 6,758 | 9,396 |
| Net gain (before tax) that would have been recognised in the Statement of other comprehensive income after the date of reclassification if the Group had not reclassified the assets | (354) | (155) |
| Interest income (before tax) recorded on reclassified assets after date of reclassification | 250 | 405 |

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

In June 2016, the merger of Visa Europe Ltd. and Visa Inc. took place. A settlement of the sales price was divided into three tranches: cash payment, transfer of preferred shares of Visa Inc. and further cash payment in 2019. In June 2016, the Group received a cash consideration in the amount of CZK 977 m as the first tranche.

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

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

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

The following table shows a reconciliation of the cumulative impairment losses on financial investments for 2016 and 2017:

| (CZKm) | Available-for-sale financial assets<br>Equity securities | Held-to-maturity investments<br>Debt securities | Total |
|---|---|---|---|
| **At 1 January 2016** | **103** | **-** | **103** |
| Increase | 2 | - | 2 |
| Utilisation | (29) | - | (29) |
| **At 31 December 2016** | **76** | **-** | **76** |
| Increase | 26 | 2 | 28 |
| Utilisation | (24) | - | (24) |
| Foreign currency translation | 3 | - | 3 |
| **At 31 December 2017** | **81** | **2** | **83** |

## 19. LOANS AND RECEIVABLES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Analysed by category of borrower** | | |
| Central banks | 475,047 | 235,003 |
| General government | 6,034 | 6,446 |
| Credit institutions | 8,805 | 10,085 |
| Other legal entities | 233,418 | 220,073 |
| Private individuals | 347,928 | 320,558 |
| Gross loans | 1,071,232 | 792,165 |
| Allowance for impairment losses | (9,031) | (10,066) |
| | **1,062,201** | **782,099** |

Balances with central banks contain reverse repo transactions provided to central bank in the amount of CZK 475,047 m at 31 December 2017 (31 December 2016: CZK 235,003 m).

Finance lease receivables may be analysed as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Total amount of the future minimum lease payments** | **17,292** | **16,059** |
| At not more than one year | 4,629 | 4,267 |
| At more than one but not more than five years | 9,343 | 8,918 |
| At more than five years | 3,320 | 2,874 |
| Unearned future finance income on finance leases | (551) | (645) |
| **Present value of the future minimum lease payments** | **16,740** | **15,414** |
| At not more than one year | 4,481 | 4,096 |
| At more than one but not more than five years | 9,045 | 8,560 |
| At more than five years | 3,214 | 2,758 |
| Accumulated allowance for uncollectible minimum lease payments receivable | (212) | (229) |

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

As at 31 December 2017, the Group possessed assets (mainly cars related to leased assets) with an estimated value of CZK 42 m (2016: CZK 17 m), which the Group is in the process of selling (Note: 24).

## 20. INVESTMENT IN ASSOCIATES AND JOINT VENTURES

The investment in ČMSS is a strategic interest of the Bank involved in the business of providing building savings loans and accepting building savings deposits. With regard to the characteristics of its business, ČMSS is exposed to credit risk. The risk is managed on the level of ČMSS while adopting the same policies and processes of credit risk management as used by the Group. Except for loan commitments given in the amount of CZK 2,322 m equivalent to the Group's share (31 December 2016: CZK 2,786 m) ČMSS had no other contingent liabilities.

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

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

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

| (CZKm) | ČMSS 2017 | ČMSS 2016 | ČSOB AM 2017 | ČSOB AM 2016 | ČSOB Pojišťovna 2017 | ČSOB Pojišťovna 2016 |
|---|---|---|---|---|---|---|
| **The associate's and joint venture's assets and liabilities** | | | | | | |
| Assets | 148,211 | 149,536 | 943 | 721 | 45,312 | 42,220 |
| of which current assets | 22,355 | 15,656 | 85 | 98 | 148 | 1,940 |
| Liabilities | 140,047 | 140,775 | 431 | 400 | 40,852 | 38,117 |
| of which current liabilities | 893 | 896 | 431 | 400 | 1,925 | 1,724 |
| **Net assets** | **8,164** | **8,761** | **512** | **321** | **4,460** | **4,103** |
| **Carrying amount of the investment** | **4,490** | **4,819** | **205** | **128** | **11** | **10** |
| **The associate's and joint venture's results** | | | | | | |
| Interest income | 4,456 | 4,874 | - | 3 | 866 | 882 |
| Interest expense | (2,282) | (2,410) | - | - | (167) | (172) |
| Total revenues | 2,736 | 3,024 | 413 | 376 | 13,511 | 13,325 |
| Depreciation and amortisation | (240) | (248) | (7) | (7) | (46) | (45) |
| Income tax expense | (202) | (270) | (46) | (37) | (198) | (190) |
| Profit for the year | 1,013 | 1,145 | 193 | 159 | 859 | 869 |
| Profit for the year – share of the Group | 558 | 630 | 77 | 64 | 2 | 2 |
| Dividend – share of the Bank | 647 | 607 | - | 41 | 2 | 2 |
| Other comprehensive income | (239) | (32) | - | - | - | - |
| Total comprehensive income | 318 | 598 | 77 | 64 | 2 | 2 |

## 21. 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 2017 and 2016 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***

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 574,187 | 7,558 | 8,064 | 551,218 | 8,822 | 10,109 |
| Forwards | 49,994 | 1 | 13 | 16,700 | 2 | - |
| Options | 25,045 | 64 | 36 | 47,043 | 94 | 105 |
| | **649,226** | **7,623** | **8,113** | **614,961** | **8,918** | **10,214** |
| **Foreign exchange contracts** | | | | | | |
| Swaps / Forwards | 374,588 | 2,137 | 3,921 | 162,525 | 1,217 | 457 |
| Cross currency interest rate swaps | 73,242 | 894 | 556 | 59,440 | 1,029 | 677 |
| Options | 106,668 | 1,024 | 1,046 | 74,236 | 571 | 569 |
| | **554,498** | **4,055** | **5,523** | **296,201** | **2,817** | **1,703** |
| **Equity contracts** | | | | | | |
| Swaps | 5,124 | 110 | 67 | 5,359 | 117 | 92 |
| Options | 6,304 | 297 | 30 | 3,231 | 163 | 23 |
| | **11,428** | **407** | **97** | **8,590** | **280** | **115** |
| **Commodity contracts** | | | | | | |
| Swaps / Options | 2,719 | 139 | 134 | 3,383 | 152 | 144 |
| **Total trading derivatives (Notes: 17, 26)** | **1,217,871** | **12,224** | **13,867** | **923,135** | **12,167** | **12,176** |

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

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 46,127 | 46 | - | 77,126 | 74 | 34 |
| **Foreign exchange contracts** | | | | | | |
| Cross currency interest rate swaps | 4,573 | 187 | - | 6,430 | 376 | 58 |
| **Total derivatives used as economic hedges (Notes: 17, 26)** | **50,700** | **233** | **-** | **83,556** | **450** | **92** |

## 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 non-retail client current accounts (the variability in the interest paid on the client deposits is effectively hedged by the fixed rate payer/floating rate receiver swaps).
- to convert floating-rate client loans to fixed rates.

Cross currency interest rate swaps are used to hedge currency risk resulting from interest income accrued on foreign currency investment debt securities. These fixed and floating interest earning securities are included in Available-for-sale financial assets and in Held-to-maturity investments of the Group's statement of financial position.

The contract or notional amounts and positive and negative fair values of the Group's outstanding cash flow hedging derivatives as at 31 December 2017 and 2016 are set out as follows:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Cash flow hedges** | | | | | | |
| Single currency interest rate swaps | 104,802 | 2,793 | 1,716 | 106,722 | 5,150 | 2,476 |
| Cross currency interest rate swaps | 11,008 | 243 | 481 | 11,922 | 422 | 866 |
| **Total hedging derivatives** | **115,810** | **3,036** | **2,197** | **118,644** | **5,572** | **3,342** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Interest income (Note: 31) | 758 | 930 |
| Net gains from financial instruments at fair value through profit or loss (Note: 31) | 63 | 12 |
| Taxation (Note: 14) | (156) | (120) |
| **Net gains** | **665** | **822** |

In 2017, a gain of CZK 50 m was recognised in the statement of income due to hedge ineffectiveness from cash flow hedges (2016: CZK 3 m).

In 2017, the discontinuation of hedge accounting (due to sales of / impairment on underlying hedged bonds or retrospective hedge effectiveness test failure) resulted in a reclassification of the associated cumulative gains of CZK 13 m from equity to the statement of income (2016: CZK 10 m). The gains / losses are included in Net gains from financial instruments at fair value through profit or loss.

Since the cash flows from the hedging interest rate swaps are variable and difficult to predict, the Group uses the remaining contractual maturity analysis of the hedging derivatives notional amounts instead of the expected future cash flows from the hedged items. As the objective of the hedging structure is to achieve fixed interest income, the information of the hedging swaps notional amounts remaining maturity is more relevant. Cash flows from hedged items are expected to occur in the same periods as the remaining maturity of cash flows from hedging derivatives.

The following table shows the notional amounts of hedging derivatives by remaining contractual maturity at 31 December 2017 and 2016:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Less than 3 months | 3,313 | 5,810 |
| More than 3 months but not more than 6 months | 5,652 | 9,492 |
| More than 6 months but not more than 1 year | 11,873 | 7,820 |
| More than 1 year but not more than 2 years | 14,697 | 20,978 |
| More than 2 years but not more than 5 years | 55,740 | 58,348 |
| More than 5 years | 24,535 | 16,196 |
| | **115,810** | **118,644** |

**Fair value hedging derivatives**

Cross currency interest rate swaps are used to hedge both FX risks and interest rate risks arising from the movement in the fair value of foreign currency fixed rate bonds classified as Available-for-sale attributable to the changes in the FX rate and the risk-free (interest rate swap) yield curve. A fixed rate payer (foreign currency)/floating rate receiver (home currency) interest rate swap is expected to be a highly effective hedge.

Interest rate swaps are used by the Group to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Available-for-sale attributable to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be a highly effective hedge.

Fair value hedges for portfolios of retail non-maturity deposits have been used to hedge interest rate risk arising from changes in fair value of non-maturity retail deposits to changes in the risk-free yield curve. The portfolio consisting of the part of retail current accounts was designated as a hedged item. The interest rate risk is effectively hedged by the single currency fixed rate receiver/floating rate payer swaps.

Fair value hedges for portfolios of fixed rate loans have been used to hedge interest rate risk arising from changes in the fair value of fixed rate loans to changes in the risk-free yield curve. The interest rate risk is effectively hedged by the single currency fixed rate payer/floating rate receiver swaps.

Interest rate swaps are used by the Group to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Loans and receivables, i.e. private issues without active secondary market, to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be a highly effective hedge.

The contract or notional amounts and positive and negative fair values of the Group's outstanding fair value hedging derivatives as at 31 December 2017 and 2016 are set out as follows:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | 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 | 55,304 | 105 | 3,001 | 51,012 | 36 | 5,118 |
| Fair value portfolio hedges | 416,794 | 5,972 | 5,210 | 304,122 | 6,048 | 2,001 |
| *Cross currency interest rate swaps* | | | | | | |
| Fair value micro hedges | 923 | - | 77 | 516 | - | 71 |
| **Total hedging derivatives** | **473,021** | **6,077** | **8,288** | **355,650** | **6,084** | **7,190** |

In 2017, the discontinuation of hedge accounting due to sales of underlying hedged bonds resulted in realised losses of CZK 159 m (2016: CZK Nil) included in Net gains from financial instruments at fair value through profit or loss in the statement of income.

In 2017, the net gains in the amount of CZK 2,705 m (2016: losses of CZK 724 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 2,535 m (2016: gains of CZK 679 m).

## 22. PROPERTY AND EQUIPMENT

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2016 | 7,601 | 674 | 589 | 4,951 | 282 | 14,097 |
| Depreciation and impairment at 1 January 2016 | (3,320) | (227) | (480) | (2,408) | - | (6,435) |
| **Net book value at 1 January 2016** | **4,281** | **447** | **109** | **2,543** | **282** | **7,662** |
| Transfers | 242 | 365 | 21 | 4,132 | (4,760) | - |
| Additions | - | - | - | - | 4,948 | 4,948 |
| Disposals | (27) | (1) | (3) | (1,503) | - | (1,534) |
| Depreciation | (274) | (193) | (31) | (200) | - | (698) |
| Depreciation related to operating leased assets (Note: 33) | - | - | - | (356) | - | (356) |
| Impairment charge (Note: 13) | (9) | - | - | (4) | - | (13) |
| **Net book value at 31 December 2016** | **4,213** | **618** | **96** | **4,612** | **470** | **10,009** |
| of which | | | | | | |
| Cost | 7,729 | 1,030 | 586 | 7,175 | 470 | 16,990 |
| Depreciation and impairment | (3,516) | (412) | (490) | (2,563) | - | (6,981) |

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2017 | 7,729 | 1,030 | 586 | 7,175 | 470 | 16,990 |
| Depreciation and impairment at 1 January 2017 | (3,516) | (412) | (490) | (2,563) | - | (6,981) |
| **Net book value at 1 January 2017** | **4,213** | **618** | **96** | **4,612** | **470** | **10,009** |
| Transfers | 627 | 296 | 52 | 2,892 | (3,867) | - |
| Additions | - | - | - | - | 4,500 | 4,500 |
| Disposals | (16) | (5) | (3) | (2,162) | - | (2,186) |
| Transfer to non-current assets held-for-sale | (6) | - | - | - | - | (6) |
| Depreciation | (254) | (272) | (27) | (202) | - | (755) |
| Depreciation related to operating leased assets (Note: 33) | - | - | - | (398) | - | (398) |
| Impairment charge (Note: 13) | (6) | - | - | (134) | - | (140) |
| **Net book value at 31 December 2017** | **4,558** | **637** | **118** | **4,608** | **1,103** | **11,024** |
| of which | | | | | | |
| Cost | 8,187 | 1,283 | 602 | 7,442 | 1,103 | 18,617 |
| Depreciation and impairment | (3,629) | (646) | (484) | (2,834) | - | (7,593) |

ČSOB Leasing owns assets leased out under operating leases, which represent 89% (2016: 88%) of the net book value of the Other class of property and equipment.

Property and equipment are assessed as non-current assets.

## 23. GOODWILL AND OTHER INTANGIBLE ASSETS

| (CZKm) | Goodwill | Acquired software | Internally developed software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2016 | 3,636 | 5,363 | 24 | 876 | 622 | 10,521 |
| Amortisation and impairment at 1 January 2016 | (1,095) | (3,284) | - | (819) | - | (5,198) |
| **Net book value at 1 January 2016** | **2,541** | **2,079** | **24** | **57** | **622** | **5,323** |
| Transfers | - | 251 | 38 | 73 | (362) | - |
| Additions | - | - | - | - | 1,045 | 1,045 |
| Disposals | - | (30) | (24) | (36) | - | (90) |
| Amortisation | - | (550) | (3) | (17) | - | (570) |
| Impairment (Note: 13) | - | (14) | - | - | (60) | (74) |
| **Net book value at 31 December 2016** | **2,541** | **1,736** | **35** | **77** | **1,245** | **5,634** |
| of which | | | | | | |
| Cost | 3,636 | 5,801 | 38 | 654 | 1,305 | 11,434 |
| Amortisation and impairment | (1,095) | (4,065) | (3) | (577) | (60) | (5,800) |

| (CZKm) | Goodwill | Acquired software | Internally developed software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2017 | 3,636 | 5,801 | 38 | 654 | 1,305 | 11,434 |
| Amortisation and impairment at 1 January 2017 | (1,095) | (4,065) | (3) | (577) | (60) | (5,800) |
| **Net book value at 1 January 2017** | **2,541** | **1,736** | **35** | **77** | **1,245** | **5,634** |
| Transfers | - | 293 | 1,515 | 11 | (1,819) | - |
| Additions | - | - | - | - | 1,025 | 1,025 |
| Disposals | - | (13) | - | (16) | - | (29) |
| Amortisation | - | (517) | (89) | (19) | - | (625) |
| Impairment (Note: 13) | - | (189) | - | - | - | (189) |
| **Net book value at 31 December 2017** | **2,541** | **1,310** | **1,461** | **53** | **451** | **5,816** |
| of which | | | | | | |
| Cost | 3,636 | 5,870 | 1,553 | 610 | 451 | 12,120 |
| Amortisation and impairment | (1,095) | (4,560) | (92) | (557) | - | (6,304) |

Included in Construction in progress is internally developed software in the net amount of CZK 356 m as at 31 December 2017 (31 December 2016: CZK 1,116 m).

Goodwill and other intangible assets are assessed as non-current assets.

Goodwill does not generate cash flows independently of other groups of assets and thus is assigned to cash generating units (CGUs) for the purposes of impairment testing. These CGUs are based upon how management monitors the business and represents the lowest level to which goodwill can be allocated on a reasonable basis. An allocation to CGUs of the Group's goodwill attributable to shareholders is shown below:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Retail segment and SME clients – Bank | 2,511 | 2,511 |
| Retail segment and SME clients – subsidiaries | 30 | 30 |
| | **2,541** | **2,541** |

**Retail segment and SME clients - Bank**

The recoverable amount for the Retail segment and SME clients - Bank was determined based on the value-in-use methodology. The calculation uses cash flow projections from business plans for the forthcoming four years which are then extrapolated for a five further years using the expected average growth rate of 3%; after that a terminal value is applied.

Cash flows in the Retail segment and SME clients - Bank are based on the net profit generated by the cash-generating unit above the required capital and a terminal value of the business. For the calculation of the terminal value a sustainable discount rate of 10.1% (2016: 10.1%) and no long term growth rates were used in 2017 and 2016.

The value in use is particularly sensitive to a number of key assumptions:

- The growth rate in forecasted cash flows beyond the terminal year of the budget. The Group has a conservative approach when calculating the terminal value, which implies that no growth rate for Retail segment and SME clients - Bank has been used for extrapolation purposes beyond the budget period.
- The risk discount rate. For Retail segment and SME clients - Bank an average risk discount rate of 10.3% has been applied (2016: 10.0%). This reflects a risk-free rate in the Eurozone, long-term inflation in the Czech market and in the Eurozone, the credit default swap spread for the Czech Republic relative to the Eurozone, an average 'beta' factor for relative market risk, including the market risk premium.

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

The outcome of the impairment assessment was that it is considered unlikely that goodwill in respect of the Retail segment and SME clients - Bank would be impaired given that the value-in-use is significantly higher than the carrying value of goodwill.

The management believes that reasonable potential changes in the key assumptions on which the recoverable amount is based would not cause it to fall below the carrying amount.

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

| (CZKm) | Investment property | Land and buildings | Other (Note: 19) | Total |
|---|---|---|---|---|
| **Net book value at 1 January 2016** | **278** | **46** | **39** | **363** |
| Additions | - | 1 | 71 | 72 |
| Disposals | (278) | (32) | (73) | (383) |
| **Net book value at 31 December 2016** | **-** | **15** | **37** | **52** |
| of which | | | | |
| Cost | - | 24 | 37 | 61 |
| Impairment | - | (9) | - | (9) |

| (CZKm) | Investment property | Land and buildings | Other (Note: 19) | Total |
|---|---|---|---|---|
| **Net book value at 1 January 2017** | **-** | **15** | **37** | **52** |
| Transfer from Property and equipment (Note: 22) | - | 6 | - | 6 |
| Additions | - | - | 78 | 78 |
| Disposals | - | (30) | (73) | (103) |
| Impairment release | - | 9 | - | 9 |
| **Net book value at 31 December 2017** | **-** | **-** | **42** | **42** |
| of which | | | | |
| Cost | - | - | 42 | 42 |
| Impairment | - | - | - | - |

In 2015, the Group decided to sell its investment property in the Czech Republic and reclassified the assets to Non-current assets held for sale. The Group sold the assets in September 2016 and received a consideration of CZK 311 m. As a result of the sale, the Group recognised a realised gain of CZK 38 m from the derecognition of held-for-sale assets reported as part of Other income in 2016.

Movements disclosed in Transfer from Property and equipment represent buildings and other property which the Group decided to sell. The buildings are measured at the lower of their carrying amount and fair value less costs to sell. The fair value of the buildings was calculated based on indicative market prices.

The impairment losses resulting from the decreased recoverable amount of the buildings were caused by a decrease of expected future cash-flows less costs to sell.

## 25. OTHER ASSETS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Other debtors, net of provisions (Notes: 32, 34, 37, 40.2) | 634 | 858 |
| Assets subject of terminated operating leasing contracts | 590 | 22 |
| Prepaid charges | 541 | 483 |
| Receivables from pension funds (Notes: 32, 34, 37, 40.2) | 430 | 394 |
| Accrued income (Notes: 32, 34, 37, 40.2) | 322 | 332 |
| VAT and other tax receivables | 169 | 132 |
| Receivables from securities clearing (Notes: 32, 34, 37, 40.2) | - | 1 |
| Other receivables from clients (Notes: 32, 34, 37, 40.2) | 11 | 8 |
| Other | 139 | 11 |
| | **2,836** | **2,241** |

Other assets are assessed as current assets.

## 26. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Financial liabilities held for trading** | | |
| Short positions | 12,952 | 13,025 |
| Derivative contracts (Note: 21) | | |
| Trading derivatives | 13,867 | 12,176 |
| Derivatives used as economic hedges | - | 92 |
| Term deposits | 362 | 3,184 |
| Repo transactions | 2,108 | 155 |
| Bonds and investment certificates issued | 5,317 | 11,412 |
| | **34,606** | **40,044** |
| **Financial liabilities designated at fair value through profit or loss** | | |
| Investment certificates | 9,498 | 1,620 |
| | **9,498** | **1,620** |
| **Financial liabilities at fair value through profit or loss** | **44,104** | **41,664** |

The amount that the Group would contractually be required to pay at the maturity of the financial liabilities designated at fair value through profit or loss is by CZK 52 m lower than the carrying amount at 31 December 2017 (31 December 2016: CZK 73 m).

The changes in the fair value of the Financial liabilities designated at fair value through profit or loss attributable to changes in own credit risk were not significant.

Included in Financial liabilities designated at fair value through profit or loss are debt instruments containing an embedded derivative.

## 27. FINANCIAL LIABILITIES AT AMORTISED COST

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Deposits received from credit institutions** | | |
| Current accounts and overnight deposits | 36,196 | 9,168 |
| Term deposits | 10,296 | 13,978 |
| Repo transactions | 22,011 | 9,452 |
| | **68,503** | **32,598** |
| **Deposits received from other than credit institutions** | | |
| Current accounts and overnight deposits | 506,522 | 441,896 |
| Term deposits | 11,806 | 8,299 |
| Savings deposits | 214,976 | 214,689 |
| Pension funds clients deposits | 51 | 29 |
| Other deposits | 11,093 | 11,249 |
| | **744,448** | **676,162** |
| **Debt securities in issue** | | |
| Bonds issued | 13,251 | 20,970 |
| Promissory notes | 336,885 | 202,027 |
| | **350,136** | **222,997** |
| **Financial liabilities at amortised cost** | **1,163,087** | **931,757** |

## 28. OTHER LIABILITIES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Payables to employees including social security charges (Notes: 32, 34, 37, 40.3) | 2,021 | 2,025 |
| Accrued charges (Notes: 32, 34, 37, 40.3) | 2,332 | 1,910 |
| Other creditors (Notes: 32, 34, 37, 40.3) | 278 | 568 |
| Income received in advance | 86 | 157 |
| Other debts to clients (Notes: 32, 34, 37, 40.3) | 176 | 122 |
| VAT and other tax payables | 128 | 104 |
| Payables to securities clearing entities (Notes: 32, 34, 37, 40.3) | 2 | 4 |
| Other (Notes: 32, 34, 37, 40.3) | 129 | 55 |
| | **5,152** | **4,945** |

Other liabilities are assessed as current liabilities.

## 29. PROVISIONS

| (CZKm) | Pending legal issues and other losses | Restructuring | Contractual engagements | Loans commitments and guarantees (Note: 35) | Total |
|---|---|---|---|---|---|
| **At 1 January 2016** | **105** | **100** | **45** | **286** | **536** |
| Additions | 334 | - | 27 | 141 | 502 |
| Amounts utilised | (62) | (51) | (35) | - | (148) |
| Unused amounts reversed | (17) | - | (8) | (195) | (220) |
| Discount amortisation (Note: 6) | - | - | 3 | - | 3 |
| **At 31 December 2016** | **360** | **49** | **32** | **232** | **673** |
| Additions | 109 | - | 9 | 345 | 463 |
| Amounts utilised | (11) | (37) | (21) | - | (69) |
| Unused amounts reversed | (37) | - | (5) | (109) | (151) |
| Discount amortisation (Note: 6) | - | - | 3 | - | 3 |
| Foreign currency translation | (3) | - | - | (2) | (5) |
| **At 31 December 2017** | **418** | **12** | **18** | **466** | **914** |

*Restructuring*

During 2015, the Group started a restructuring programme, resulting in the creation of a provision of CZK 100 m. In the framework of this restructuring programme the total number of personnel was reduced in 2016 and 2017.

*Pending legal issues and other losses*

Provisions for legal issues and other losses represent an obligation to cover potential risks resulting from litigation, where the Group is the defendant.

The Group is involved in a number of ongoing legal disputes, the resolution of which may have an adverse financial impact on the Group. Based upon historical experience and expert reports, the Group assesses the developments in these cases, and the likelihood and the amount of potential financial losses which are appropriately provided for.

The Group's policy is to create a provision, where the possibility of an outflow of resources embodying economic benefits to settle the obligation is more than 50%. In such cases the Group creates a provision in the full amount to cover the possible cost in the event of loss.

In 2017, the Group had a provision for pending legal issues and other losses in the total amount of CZK 418 m. It is expected that the majority of the costs will be incurred in the next 3 years.

On a quarterly basis, the Group monitors the status of all cases and makes a decision whether to create, utilise or reverse any provision.

The Group does not disclose the details underlying the disputes as the disclosure may have an impact on the outcome of the disputes and may seriously harm the Group's interests.

*Contractual engagements*

A number of leasehold property arrangements for which, on a net basis, the unavoidable contractual rental costs exceeds normal market rental conditions exists in the Group. This provision represents the present value of the future net rental losses that will arise. It is expected that a majority of the costs will be incurred over the next 3 years.

## 30. SHARE CAPITAL AND OTHER RESERVES

As at 31 December 2017, the total authorised share capital was CZK 5,855 m (31 December 2016: CZK 5,855 m) and comprised of 292,750,002 ordinary shares with a nominal value of CZK 20 each (31 December 2016: 292,750,002 ordinary shares with a nominal value of CZK 20 each) and is fully paid up.

No Treasury shares were held by the Group at 31 December 2017 and 2016.

On 31 December 2017, the Bank was directly controlled by KBC Bank whose ownership interest in ČSOB was 100% (31 December 2016: 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 2017 and 2016 are as follows:

| (CZKm) | Available-for-sale reserve | Cash flow hedge reserve | Total |
|---|---|---|---|
| **At 1 January 2016** | **3,944** | **2,609** | **6,553** |
| Other comprehensive income (Note: 31) | (1,716) | (636) | (2,352) |
| **At 31 December 2016** | **2,228** | **1,973** | **4,201** |
| Other comprehensive income (Note: 31) | (738) | (1,477) | (2,215) |
| **At 31 December 2017** | **1,490** | **496** | **1,986** |

## 31. COMPONENTS OF OTHER COMPREHENSIVE INCOME

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Cash flow hedges** | | |
| Net unrealised (loss) / gains on cash flow hedges | (1,002) | 157 |
| Net gains on cash flow hedges reclassified to the statement of income (Note: 21) | (821) | (942) |
| Tax effect relating to cash flow hedges (Note: 14) | 346 | 149 |
| | (1,477) | (636) |
| **Available-for-sale financial assets** | | |
| Net unrealised losses on available-for-sale financial investments | (31) | (589) |
| Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal | (455) | (1,294) |
| Net realised gains on available-for-sale financial investments amortised to the statement of income on reclassified assets (Note: 18) | (143) | (197) |
| Realised losses on available-for-sale financial investments reclassified to the statement of income on impairment | 13 | - |
| Tax effect relating to available-for-sale financial investments (Note: 14) | 117 | 396 |
| | (499) | (1,684) |
| **Share of other comprehensive income of associates** | (239) | (32) |
| **Other comprehensive income for the year, net of tax attributable to owners of the parent** | **(2,215)** | **(2,352)** |
| Non-controlling interests | - | 1 |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | **(2,215)** | **(2,351)** |

In 2016, net gain of CZK 1,295 m resulting from the transaction of merger Visa Inc. and Visa Europe Ltd. is reported as part of Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal.

## 32. FAIR VALUE OF FINANCIAL INSTRUMENTS

### Financial assets and liabilities at fair value

The Group's accounting policy on fair value measurements is discussed in the Accounting policies (Note 2.4 (3)).

Financial assets and liabilities at fair value (available-for-sale, held for trading, designated at fair value through profit or loss) are valued as follows:

- Level 1

  If available, published price quotations in active markets are used to determine the fair value of financial assets or financial liabilities. Revaluation is obtained using prices of an identical asset or liability, which means that no model is involved in the process of a revaluation. Financial instruments valued on this basis include spot foreign exchange contracts and listed shares and bonds.

  Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Group determines fair values using valuation techniques.

- Level 2

  Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observed from the market.

  Financial instruments valued on this basis include forward interest rate, foreign exchange and commodity contracts, mortgage bonds, money market loans and deposits.

- Level 3

  Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

  Financial instruments for which the parameters are not observable include unlisted shares, a part of the portfolio of trading derivatives, a part of the portfolio of mortgage bonds and selected listed but not traded bonds.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to determine a fair value that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Group uses widely recognised valuation models for determining the fair value of common and less complex financial instruments like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter derivatives like interest rate swaps. The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Group uses proprietary valuation models, which are usually developed from recognised valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Examples of instruments involving significant unobservable inputs include certain over-the-counter structured derivatives, certain loans and securities for which there is no active market. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, the determination of expected future cash flows on the financial instrument being valued, the determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The Valuation policy is subject to approval of the ČSOB Risk and Capital Oversight Committee and KBC Group Valuation Committee. The process for the approval of any new product consist also of an assessment of the valuation of the product and the eventual new valuation model for the product has to be approved before the product is endorsed or approval of the model is a blocking condition for the product implementation. The New and Active Product Process also requires a regular review of all products and the assessment of valuation quality is an important part of the review. Any valuation model, which uses not directly observable inputs, is subject to the Parameter review policy. The policy requires quarterly assessment of all parameters correctness. The Group currently checks the valuation of all bonds quarterly.

The Group also monitors the quality of bonds valuations on a daily basis. If an asset quote quality does not meet the required criteria for Level 1 or Level 2 the asset is transferred to Level 3 and vice versa. The monitoring process evaluates among others the frequency of quote updates.

The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2017:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | 39 | - | 39 |
| Debt instruments | 133 | 318 | 3,289 | 3,740 |
| Equity securities | 9 | - | - | 9 |
| Derivative contracts | - | 12,257 | 200 | 12,457 |
| Financial assets held for trading pledged as collateral | | | | |
| Debt instruments | 1,900 | 197 | - | 2,097 |
| Available-for-sale financial assets | | | | |
| Debt securities | 27,446 | 231 | 1,345 | 29,022 |
| Equity securities | - | - | 460 | 460 |
| Available-for-sale financial assets pledged as collateral | | | | |
| Debt securities | 3,118 | - | 2,729 | 5,847 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (4,298) | - | (4,298) |
| Derivatives used for hedging | - | 9,113 | - | 9,113 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 12,952 | - | - | 12,952 |
| Derivative contracts | - | 13,787 | 80 | 13,867 |
| Term deposits | - | 362 | - | 362 |
| Repo transactions | - | 2,108 | - | 2,108 |
| Bonds issued | - | 5,317 | - | 5,317 |
| Financial liabilities designated at fair value through profit or loss | | | | |
| Debt instruments | - | 2,545 | 6,953 | 9,498 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (3,803) | - | (3,803) |
| Derivatives used for hedging | - | 10,485 | - | 10,485 |

The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | 170 | - | 170 |
| Debt instruments | 2,508 | 762 | 3,382 | 6,652 |
| Equity securities | 1 | - | - | 1 |
| Derivative contracts | - | 12,517 | 100 | 12,617 |
| Financial assets held for trading pledged as collateral | | | | |
| Debt instruments | 568 | - | - | 568 |
| Available-for-sale financial assets | | | | |
| Debt securities | 37,825 | 13,261 | 2,359 | 53,445 |
| Equity securities | - | - | 416 | 416 |
| Available-for-sale financial assets pledged as collateral | | | | |
| Debt securities | 1,009 | - | 2,068 | 3,077 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 852 | - | 852 |
| Derivatives used for hedging | - | 11,656 | - | 11,656 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 13,025 | - | - | 13,025 |
| Derivative contracts | - | 12,126 | 142 | 12,268 |
| Term deposits | - | 3,184 | - | 3,184 |
| Repo transactions | - | 155 | - | 155 |
| Bonds issued | - | 11,412 | - | 11,412 |
| Financial liabilities designated at fair value through profit or loss | | | | |
| Debt instruments | - | 1,620 | - | 1,620 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 4,796 | - | 4,796 |
| Derivatives used for hedging | - | 10,532 | - | 10,532 |

Yield curve used in the mortgage bonds valuation model for discounting future cash flows is constructed from IRS rates and respective credit spreads. The credit spreads are derived from available market quotes of mortgage bonds, government bonds and IRS rates.

The spreads for the first year of maturity are exclusively derived from market observable quotes of mortgage bonds. Therefore mortgage bonds with a maturity of up to one year are included in Level 2. The spread for the rest of the curve are derived from observed mortgage bond spread at one year and slope of the Czech government yield curve. The management considers this a significant market unobservable input, and as a consequence, the mortgage bonds with a maturity of longer than one year are reported as part of Level 3.

The spread according to bond maturity was 96 bps (7-year) to 182 bps (above 30-year) in 2016 and 74 bps (2-year) to 102 bps (above 20-year) in 2017.

Valuation of bonds issued by Česká Exportní Banka (ČEB) is based on model using unobservable inputs. Yield curves (different for floating and fix bonds) used in the ČEB bonds valuation model for discounting future cash flows are constructed from IRS rates and respective credit spreads. The credit spreads are derived from the quotes of the most liquid bonds issued by ČEB and IRS rates.
The management considers this a significant market unobservable input and, as a consequence, the bonds issued by ČEB are classified as Level 3.

The spreads are regularly updated, at the latest quarterly. The spread according to bond maturity was 5 bps (1-year) to 215 bps (10-year) for fixed bonds and 9 bps (1-year) to 42 bps (10-year) for floating bonds after last review in December 2017 (31 December 2016: 16 bps (1-year) to 195 bps (10-year) for fixed bonds and 12 bps (1-year) to 53 bps (10-year) for floating bonds).

The Group's share in Visa Inc. classified as Available-for-sale financial asset is subject to fair value measurement based on the quoted price of Visa Inc.

All transfers of financial instruments among the levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

### Movements in Level 3 financial instruments measured at fair value

The following table shows the reconciliation of the opening and closing amount of financial assets which are recorded at fair value using valuation techniques based on non-market observable inputs:

| | Financial assets held for trading | | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets (incl. assets pledged as collateral) | | Total |
|---|---|---|---|---|---|---|
| (CZKm) | Debt securities | Financial derivatives | Debt securities | Debt securities | Equity securities | |
| **At 1 January 2016** | **5,714** | **89** | **15** | **4,388** | **1,330** | **11,536** |
| Total gains / (losses) recorded in profit or loss | 60 | 199 | 5 | - | 10 | 274 |
| Total gains recorded in other comprehensive income | - | - | - | 73 | 17 | 90 |
| Transfers into level 3 | 40 | - | - | - | - | 40 |
| Transfers out of level 3 | (814) | - | - | - | - | (814) |
| Purchases | 2,362 | - | - | - | 354 | 2,716 |
| Settlement | (991) | (188) | - | - | - | (1,179) |
| Sales | (2,989) | - | (20) | (34) | (1,295) | (4,338) |
| **At 31 December 2016** | **3,382** | **100** | **-** | **4,427** | **416** | **8,325** |
| Total gains recorded in profit or loss related to assets held at the end of the reporting period | 47 | 199 | - | - | - | **246** |

| (CZKm) | Financial assets held for trading | | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets (incl. assets pledged as collateral) | | Total |
|---|---|---|---|---|---|---|
| | Debt securities | Financial derivatives | Debt securities | Debt securities | Equity securities | |
| **At 1 January 2017** | **3,382** | **100** | **-** | **4,427** | **416** | **8,325** |
| Total gains / (losses) recorded in profit or loss | (288) | 240 | - | (170) | - | (218) |
| Total gains recorded in other comprehensive income | - | - | - | (74) | 64 | (10) |
| Transfers into level 3 | 58 | - | - | - | - | 58 |
| Transfers out of level 3 | (76) | - | - | - | - | (76) |
| Purchases | 1,040 | - | - | - | 10 | 1,050 |
| Settlement | (141) | (140) | - | - | (6) | (287) |
| Sales | (686) | - | - | (109) | - | (795) |
| Impairment losses | - | - | - | - | (24) | (24) |
| **At 31 December 2017** | **3,289** | **200** | **-** | **4,074** | **460** | **8,023** |
| Total losses recorded in profit or loss related to assets held at the end of the reporting period | (278) | 240 | - | (170) | - | **(208)** |

Total 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 on available-for-sale financial assets and Impairment losses of the statement of income.

The following table shows the reconciliation of the opening and closing amount of financial liabilities which are recorded at fair value using valuation techniques based on non-market observable inputs:

| (CZKm) | Financial liabilities held for trading | Financial liabilities designated at fair value through profit or loss | Total |
|---|---|---|---|
| | Financial derivatives | Investment certificates | |
| **At 1 January 2016** | **162** | **-** | **162** |
| Total losses recorded in profit or loss | 178 | - | 178 |
| Settlement | (198) | - | (198) |
| **At 31 December 2016** | **142** | **-** | **142** |
| Total losses recorded in profit or loss related to liabilities held at the end of the reporting period | 178 | - | 178 |
| **At 1 January 2017** | **142** | **-** | **142** |
| Total losses recorded in profit or loss | 72 | 37 | 109 |
| Issued | - | 6,916 | 6,916 |
| Settlement | (134) | - | (134) |
| **At 31 December 2017** | **80** | **6,953** | **7,033** |
| Total losses recorded in profit or loss related to liabilities held at the end of the reporting period | 72 | 37 | 109 |

Total losses recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss of the statement of income.

### Impact on fair value of Level 3 financial instruments measured at fair value of changes to key assumptions

Management considers the value of the credit spread included in the discount factor applied on estimated future cash flows from the mortgage bonds in periods after the first 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 2017, an increase / (decrease) of the credit spread by 50 basis points would (decrease) / increase the fair value of the mortgage bonds and bonds issued by ČEB included in Level 3 by CZK 40 m and CZK 65 m, respectively (2016: CZK 49 m and CZK 84 m, respectively). Such a change in the credit spread is based on the variability of mortgage bond and ČEB bond quotes that were observed by the management on the market.

Management believes that reasonably possible changes in other non-observable market inputs in the valuation models used would not have a material impact on the estimated fair values.

### Transfers between Level 1 and 2 of the fair value hierarchy for financial instruments

In 2016 and 2017, no transfers were made 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.

### 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:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| (CZKm) | Carrying value | Fair value | Carrying value | Fair value |
| **Financial assets** | | | | |
| Cash, balances with central banks and other demand deposits | 54,499 | 54,499 | 58,198 | 58,198 |
| Loans and receivables | 1,062,201 | 1,054,207 | 782,099 | 789,546 |
| Held-to-maturity investments | 86,604 | 95,483 | 116,626 | 135,265 |
| Held-to-maturity investments pledged as collateral | 29,017 | 30,814 | 16,053 | 16,434 |
| Other assets (Note: 25) | 1,397 | 1,397 | 1,593 | 1,593 |
| **Financial liabilities** | | | | |
| Financial liabilities at amortised cost | 1,163,087 | 1,162,520 | 931,757 | 932,028 |
| Other liabilities (Note: 28) | 4,938 | 4,938 | 4,684 | 4,684 |

The following table shows an analysis of assets and liabilities for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2017:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets for which fair values are disclosed** | | | | |
| Cash, balances with central banks and other demand deposits | 9,745 | 44,754 | - | 54,499 |
| Loans and receivables | - | 477,750 | 576,457 | 1,054,207 |
| Held-to-maturity investments | 93,190 | - | 2,293 | 95,483 |
| Held-to-maturity investments pledged as collateral | 30,814 | - | - | 30,814 |
| Other assets (Note: 25) | - | 1,397 | - | 1,397 |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Financial liabilities at amortised cost | - | 1,106,802 | 55,718 | 1,162,520 |
| Other liabilities (Note: 28) | - | 4,938 | - | 4,938 |

The following table shows an analysis of assets and liabilities for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets for which fair values are disclosed** | | | | |
| Cash, balances with central banks and other demand deposits | 9,077 | 49,121 | - | 58,198 |
| Loans and receivables | - | 238,413 | 551,133 | 789,546 |
| Held-to-maturity investments | 132,854 | - | 2,411 | 135,265 |
| Held-to-maturity investments pledged as collateral | 16,434 | - | - | 16,434 |
| Other assets (Note: 25) | - | 1,593 | - | 1,593 |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Financial liabilities at amortised cost | - | 903,163 | 28,865 | 932,028 |
| Other liabilities (Note: 28) | - | 4,684 | - | 4,684 |

The following methods and assumptions were applied in estimating the fair values of the Group's financial assets and liabilities:

**Held-to-maturity investments**

Fair values for held-to-maturity securities are based on quoted market prices, where available. Such quotes are obtained from relevant exchanges, if exchange activity for the particular security is considered sufficiently liquid, or from reference rates averaging market maker quotes. If quoted market prices are not available, fair values are estimated from quoted market prices of comparable instruments or using the valuation model based on discounted cash flows.

**Loans and receivables to credit institutions and balances with central banks**

The carrying values of current account balances are equal to their fair values. The fair values of term placements with credit institutions and central banks are estimated by discounting their future cash flows using current interbank market rates, including the respective credit spread derived from the Group's own experience of probability of default and loss given default. A majority of the loans reprice within relatively short time periods, therefore, it is assumed that their carrying values approximate their fair values.

**Loans and receivables to other than credit institutions**

A substantial majority of the loans to customers reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values. The fair values of fixed-rate loans to customers are estimated by discounting their future cash flows using current market rates including the respective credit spread derived from the Group's own experience of probability of default and loss given default. Fair value incorporates expected future losses, while amortised cost and related impairment include only incurred losses at the end of the accounting period.

**Deposits received from credit institutions and subordinated liabilities**

The carrying values of current account balances are equal to their fair values. For other amounts due to credit institutions with equal to or less than one year remaining maturity, it is assumed that their carrying values approximate their fair values. The fair values of other amounts due to credit institutions are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spread.

**Deposits received from other than credit institutions**

The fair values of current accounts and term deposits, with equal to or less than one year remaining to maturity, approximate their carrying values. The fair values of other term deposits are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spreads.

### Debt securities in issue

The fair values of bonds issued are estimated by discounting their future cash flows using Czech government bond rates adjusted by credit spread derived from market observable transactions with respective or comparable bonds. The carrying values of promissory notes and certificates of deposit approximate their fair values.

### Other assets and other liabilities

A majority of other assets and liabilities have a remaining maturity equal to or less than one year or reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values.

## 33. ADDITIONAL CASH FLOW INFORMATION

### Analysis of the balances of cash and cash equivalents as shown in the statement of financial position

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Cash, balances with central banks and other demand deposits (Note: 16) | 54,499 | 58,198 |
| Loans and advances to credit institutions and central banks | 477,454 | 237,982 |
| Financial liabilities at amortised cost to credit institutions and central banks | (36,324) | (9,872) |
| Financial liabilities at amortised cost - promissory notes issued to credit institutions | (310,147) | (195,995) |
| **Cash and cash equivalents** | **185,482** | **90,313** |

### Change in operating assets

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Net change in financial assets held for trading (incl. assets pledged as collateral) | 1,666 | 9,486 |
| Net change in financial assets designated at fair value through profit or loss | - | 15 |
| Net change in available-for-sale financial assets (incl. assets pledged as collateral) | 20,217 | 658 |
| Net change in loans and receivables | (40,524) | (40,528) |
| Net change in derivatives used for hedging | 720 | (541) |
| Net change in other assets | (730) | 21 |
| | **(18,651)** | **(30,889)** |

### Change in operating liabilities

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Net change in financial liabilities held for trading | (5,437) | 10,075 |
| Net change in financial assets designated at fair value through profit or loss | 7,878 | 1,620 |
| Net change in financial liabilities at amortised cost | 98,445 | 61,452 |
| Net change in derivatives used for hedging | (47) | (242) |
| Net change in other liabilities | 197 | 182 |
| | **101,036** | **73,087** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Depreciation and amortisation | 1,380 | 1,268 |
| Foreign exchange differences in held-to-maturity investments | 1,049 | (129) |
| Depreciation related to operating leases assets (Note: 22) | 398 | 356 |
| Impairment on intangible assets (Note: 13) | 189 | 74 |
| Impairment on property, plant and equipment (Note: 13) | 140 | 13 |
| Impairment on other assets (Note: 13) | 136 | 2 |
| Allowances and provisions for credit losses (Note: 13) | 131 | 617 |
| Impairment on financial investments (Note: 13) | 28 | 2 |
| Creation of provisions | - | 37 |
| Impairment on non-current assets held-for-sale (Note: 13) | (9) | - |
| Share of profit of associates and joint ventures | (637) | (696) |
| Net change in fair value adjustments of the hedged items in portfolio hedge | (3,449) | 839 |
| Other | 452 | 52 |
| | **(192)** | **2,435** |

The table below sets out the movements of the debt instruments issued by the Group in 2016 and 2017. The debt items are those that are reported within net cash flows used in financing activities in the consolidated statement of cash flows:

| (CZKm) | Financial liabilities at amortised cost Bonds issued |
|---|---|
| **At 1 January 2016** | **20,633** |
| Cash flows | 337 |
| **At 31 December 2016** | **20,970** |
| Cash flows | (7,719) |
| **At 31 December 2017** | **13,251** |

## 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 2017:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash, balances with central banks and other demand deposits (Note: 16) | 44,754 | - | - | - | **44,754** |
| Financial assets held for trading | | | | | |
| Financial derivatives | 4,055 | 6,525 | 1,877 | - | **12,457** |
| Other than financial derivatives | 227 | 2,227 | 1,325 | 9 | **3,788** |
| Financial assets held for trading pledged as collateral | - | 196 | 1,901 | - | **2,097** |
| Available-for-sale financial assets | 581 | 13,838 | 14,603 | 460 | **29,482** |
| Available-for-sale financial assets pledged as collateral | 41 | 891 | 4,915 | - | **5,847** |
| Loans and receivables | 601,827 | 182,609 | 277,765 | - | **1,062,201** |
| Fair value adjustments of the hedged items in portfolio hedge | (1,173) | (3,415) | 290 | - | **(4,298)** |
| Held-to-maturity investments | 11,187 | 42,793 | 32,624 | - | **86,604** |
| Held-to-maturity investments pledged as collateral | 4,394 | 19,994 | 4,629 | - | **29,017** |
| Derivatives used for hedging | 2,499 | 6,061 | 553 | - | **9,113** |
| Other assets (Note: 25) | 1,397 | - | - | - | **1,397** |
| **Total carrying value** | **669,789** | **271,719** | **340,482** | **469** | **1,282,459** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 5,726 | 6,535 | 1,605 | - | **13,866** |
| Other than financial derivatives | 15,343 | 5,224 | 173 | - | **20,740** |
| Financial liabilities designated at fair value through profit or loss | 13 | 7,547 | 1,938 | - | **9,498** |
| Financial liabilities at amortised cost | 487,728 | 330,797 | 344,562 | - | **1,163,087** |
| Fair value adjustments of the hedged items in portfolio hedge | (261) | (1,473) | (2,069) | - | **(3,803)** |
| Derivatives used for hedging | 1,985 | 5,190 | 3,310 | - | **10,485** |
| Other liabilities (Note: 28) | 4,938 | - | - | - | **4,938** |
| **Total carrying value** | **515,472** | **353,820** | **349,519** | **-** | **1,218,811** |

The following table sets out the financial assets and liabilities of the Group by expected remaining maturity as at 31 December 2016:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | **Total** |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash, balances with central banks and other demand deposits (Note: 16) | 49,121 | - | - | - | **49,121** |
| Financial assets held for trading | | | | | |
| Financial derivatives | 3,493 | 6,670 | 2,454 | - | **12,617** |
| Other than financial derivatives | 1,163 | 1,802 | 3,857 | 1 | **6,823** |
| Financial assets held for trading pledged as collateral | 1 | - | 567 | - | 568 |
| Available-for-sale financial assets | 13,808 | 11,966 | 27,671 | 416 | **53,861** |
| Available-for-sale financial assets pledged as collateral | 16 | 1,001 | 2,060 | - | 3,077 |
| Loans and receivables | 355,632 | 165,438 | 261,029 | - | **782,099** |
| Fair value adjustments of the hedged items in portfolio hedge | 563 | 289 | - | - | **852** |
| Held-to-maturity investments | 13,356 | 56,742 | 46,528 | - | **116,626** |
| Held-to-maturity investments pledged as collateral | 5,288 | 7,909 | 2,856 | | 16,053 |
| Derivatives used for hedging | 2,732 | 6,946 | 1,978 | - | **11,656** |
| Other assets (Note: 25) | 1,593 | - | - | - | **1,593** |
| **Total carrying value** | **446,766** | **258,763** | **349,000** | **417** | **1,054,946** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 3,315 | 6,759 | 2,194 | - | **12,268** |
| Other than financial derivatives | 18,744 | 6,718 | 2,314 | - | **27,776** |
| Financial liabilities designated at fair value through profit or loss | 57 | 1,248 | 315 | - | **1,620** |
| Financial liabilities at amortised cost | 325,267 | 292,979 | 313,511 | - | **931,757** |
| Fair value adjustments of the hedged items in portfolio hedge | 545 | 2,938 | 1,313 | - | **4,796** |
| Derivatives used for hedging | 2,764 | 5,616 | 2,152 | - | **10,532** |
| Other liabilities (Note: 28) | 4,684 | - | - | - | **4,684** |
| **Total carrying value** | **355,376** | **316,258** | **321,799** | **-** | **993,433** |

## 35. CONTINGENT ASSETS, LIABILITIES AND COMMITMENTS

### Contingent assets

Based on a court ruling, the Group recovered a written-off loan amounting to CZK 485 m in 2007. Due to the uncertainty regarding the continuing court proceedings following the appeal by the counterparty against the decision, the Group will not recognise this amount in the statement of income until the final court decision regarding the Group's claim. In 2011, the original court ruling was cancelled and the legal case was passed to the court in the first instance for new judicial proceedings. Based on that decision, the Group returned the expenses compensation of CZK 3 m from the total received amount from the original court case to the counterparty. Judicial proceeding is continuing at the Supreme court.

### Contingent liabilities and commitments

The contingent liabilities and commitments at 31 December 2017 and 2016 are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Loan commitments – irrevocable (Note: 40.2) | 125,527 | 118,292 |
| Loan commitments – revocable | 52,272 | 44,732 |
| Financial guarantees (Note: 40.2) | 32,879 | 30,243 |
| Other commitments (Note: 40.2) | 1,340 | 1,324 |
| | **212,018** | **194,591** |
| Provisions for loan commitments and guarantees (Notes: 29, 40.2) | 466 | 232 |

Revocable loan commitments are such commitments in which the Group may at any time limit the amount that may be drawn under the credit limit. Further the Group may not provide any drawdown under the credit facility requested by the client or the Group can suspend further drawdowns under the credit facility all together. The Group can do so with or without specifying the reason, giving a prior notice or stipulating any time limit. Loan commitments which do not meet the above definition are assessed as irrevocable.

The contractual amounts described above represent the maximum credit risk that would arise if the contracts were fully drawn, the customers defaulted and the value of any existing collateral became worthless. Many of the commitments are collateralised and most are expected to expire without being drawn upon; therefore, the total commitment contractual amounts do not necessarily represent the risk of loss or future cash requirements (Note: 40.3).

The Group is obliged by law to guarantee the positive results and equity position of the Transformed fund. With regard to the conservative investment policy and investment limits of the Transformed fund the management of the Group is convinced it is not probable the guarantee will be used.

**Litigation**

Other than the litigations, for which provisions have already been made (Note: 29), the Group is named in and is defending a number of legal actions in various jurisdictions arising in the ordinary course of business. The Group does not believe that the ultimate resolution of these legal actions will result in a material impact on the financial position of the Group.

The Group is subject to a number of claims in the context of the IPB acquisition amounting to tens of billions of Czech Crowns. The Group believes that such claims are unfounded. In addition, the Group believes that potential risk arising from such claims is covered by guarantee agreements issued by the institutions of the Czech state.

Further, the Group has initiated a number of legal actions to protect its assets.

**Taxation**

Czech tax legislation, interpretation and guidance are still evolving. Consequently, under the current taxation environment, it is difficult to predict the interpretations that the respective tax authorities may apply in a number of areas. As a result, the Group has used its current understanding of the tax legislation in the design of its planning and accounting policies. The effect of the uncertainty cannot be quantified.

**Operating lease commitments (Group is the lessee)**

Future minimum lease payments under operating leases related to information technologies, land and buildings are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Not later than 1 year | 455 | 483 |
| Later than 1 year and not later than 5 years | 906 | 880 |
| Later than 5 years | 190 | 195 |
| | **1,551** | **1,558** |

Future minimum sublease payments amounted to CZK 1 m as at 31 December 2017 (31 December 2016: CZK 4 m).

The operating leases related to land and buildings can be technically cancelled under Czech law; however, the Group is commercially bound to continue with these leases for the periods set out above.

### Operating lease receivables (Group is the lessor)

Future minimum lease payments (including sublease payments) under operating leases related to land and buildings and movables are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Not later than 1 year | 532 | 429 |
| Later than 1 year and not later than 5 years | 646 | 510 |
| Later than 5 years | 1 | 2 |
| | **1,179** | **941** |

These operating leases can be technically cancelled under the Czech law; however, the lessees are commercially bound to continue with these leases for the periods set out above.

### Commitments

Capital expenditure contracted at the balance sheet date but not yet incurred in respect of the Group's new head office building is CZK 1,847 m (2016: CZK 1,832 m).

## 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) | 2017 | 2016 |
|---|---|---|
| **Financial assets** | | |
| Financial assets held for trading | 39 | 155 |
| Loans and receivables | 478,202 | 237,993 |
| | **478,241** | **238,148** |

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 2017 was CZK 495,932 m, of which CZK 30,703 m has been either sold or repledged (31 December 2016: CZK 239,447 m and CZK 16,596 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) | 2017 | 2016 |
|---|---|---|
| **Financial liabilities** | | |
| Financial liabilities held for trading | 2,108 | 155 |
| Financial liabilities at amortised cost | 22,011 | 9,452 |
| | **24,119** | **9,607** |

The Group contracts repo operations under the standard conditions currently applied on the market. Amounts of financial assets pledged as collateral in repo transactions and securities lending are described in Financial assets at fair value through profit or loss (Note: 17) and Financial investments (Note: 18).

## 37. OFFSET FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The following table shows an analysis of the financial assets and liabilities of the Group that have not been set-off as at 31 December 2017:

| (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 | 18,483 | - | 18,483 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 3,087 | - | 3,087 |
| **Total trading and hedging derivatives** | **21,570** | **-** | **21,570** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 478,241 | - | 478,241 |
| **Total repurchase agreements (Note: 36)** | **478,241** | **-** | **478,241** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,392 | - | 18,392 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 5,960 | - | 5,960 |
| **Total trading and hedging derivatives** | **24,352** | **-** | **24,352** |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 24,119 | - | 24,119 |
| **Total repurchase agreements (Note: 36)** | **24,119** | **-** | **24,119** |

The following table shows an analysis of the financial assets and liabilities of the Group that have not been set-off as at 31 December 2016:

| (CZKm) | Gross amounts of recognised financial instrument | Gross amounts of recognised financial instrument set-off | Net amounts of financial instrument presented in the balance sheet |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 19,087 | - | 19,087 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 5,186 | - | 5,186 |
| **Total trading and hedging derivatives** | **24,273** | **-** | **24,273** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 238,148 | - | 238,148 |
| **Total repurchase agreements (Note: 36)** | **238,148** | **-** | **238,148** |
| Other financial assets not set-off that are not subject to an enforceable master netting arrangement | 1,199 | - | 1,199 |
| **Total other financial assets (Note: 25)** | **1,199** | **-** | **1,199** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 20,647 | - | 20,647 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 2,153 | - | 2,153 |
| **Total trading and hedging derivatives** | **22,800** | **-** | **22,800** |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 9,607 | - | 9,607 |
| **Total repurchase agreements (Note: 36)** | **9,607** | **-** | **9,607** |
| Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement | 4,684 | - | 4,684 |
| **Total other financial liabilities (Note: 28)** | **4,684** | **-** | **4,684** |

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 2017:

| (CZKm) | Net amounts of financial assets and liabilities presented in the balance sheet | Amounts not set-off in the balance sheet | | | |
|---|---|---|---|---|---|
| | | Financial instruments | Cash collateral | Securities collateral | Total net amount |
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,483 | 16,502 | 1,651 | - | 330 |
| Debt securities pledged as collateral in repo transaction not set-off that are subject to an enforceable master netting arrangements | 24,119 | 24,119 | - | - | - |
| **Total carrying value** | **42,602** | **40,621** | **1,651** | **-** | **330** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,392 | 16,502 | 1,643 | - | 247 |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 24,119 | - | - | 24,119 | - |
| **Total carrying value** | **42,511** | **16,502** | **1,643** | **24,119** | **247** |

The following table shows an analysis of the financial assets and liabilities of the Group that have not been set-off and are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2016:

| (CZKm) | Net amounts of financial assets and liabilities presented in the balance sheet | Amounts not set-off in the balance sheet | | | |
|---|---|---|---|---|---|
| | | Financial instruments | Cash collateral | Securities collateral | Total net amount |
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 19,087 | 17,747 | 1,054 | - | 286 |
| Debt securities pledged as collateral in repo transaction not set-off that are subject to an enforceable master netting arrangements | 9,607 | 9,607 | - | - | - |
| **Total carrying value** | **28,694** | **27,354** | **1,054** | **-** | **286** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 20,647 | 17,747 | 2,699 | - | 201 |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 9,607 | - | - | 9,607 | - |
| **Total carrying value** | **30,254** | **17,747** | **2,699** | **9,607** | **201** |

The amounts in both tables are subject to master netting agreement in accordance with International Swaps and Derivatives Association (ISDA), however with no intention to settle them on a net basis.

## 38. RELATED PARTY DISCLOSURES

A number of transactions are executed with related parties in the normal course of business.

The outstanding balances of assets from related party transactions as at 31 December 2017 are as follows:

| (CZKm) | Cash, balances with central banks and other demand deposits | Financial assets held for trading | Loans and receivables | Derivatives used for hedging | Other assets |
|---|---|---|---|---|---|
| Directors / Top management | - | - | - | - | - |
| KBC Bank | 550 | 3,121 | 1,434 | 7,065 | - |
| Entities under common control | | | | | |
| ČSOB SK | 44 | 8 | - | - | - |
| KBC Securities NV | 4 | - | 3 | - | - |
| Other | 19 | 19 | 127 | - | 3 |
| Associates | | | | | |
| ČSOB AM | - | - | 144 | - | - |
| ČSOB Pojišťovna | - | 145 | - | - | 34 |
| Joint ventures | | | | | |
| ČMSS | - | - | 40 | 20 | 23 |

The outstanding balances of liabilities from related party transactions as at 31 December 2017 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Top management | - | 212 | - | 48 |
| KBC Bank | 2,254 | 341,456 | 9,320 | 3 |
| Entities under common control | | | | |
| ČSOB SK | 2,098 | 43 | - | - |
| KBC Securities NV | - | 1 | - | 3 |
| Other | 2 | 93 | - | 59 |
| Associates | | | | |
| ČSOB AM | - | 835 | - | - |
| ČSOB Pojišťovna | 43 | 2,300 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 3,616 | 8 | - |

The outstanding balances of assets from related party transactions as at 31 December 2016 are as follows:

| (CZKm) | Cash, balances with central banks and other demand deposits | Financial assets held for trading | Loans and receivables | Derivatives used for hedging | Other assets |
|---|---|---|---|---|---|
| Directors / Top management | - | - | - | - | - |
| KBC Bank | 153 | 2,892 | 1,158 | 7,903 | - |
| Entities under common control | | | | | |
| ČSOB SK | 15 | 1 | 36 | - | 15 |
| KBC Investment Limited | - | 211 | - | - | - |
| KBC Securities NV | 6 | - | 111 | - | 1 |
| Other | - | 33 | 136 | - | - |
| Associates | | | | | |
| ČSOB AM | - | - | 130 | - | - |
| ČSOB Pojišťovna | - | 396 | - | - | 26 |
| Joint ventures | | | | | |
| ČMSS | - | - | 40 | - | 41 |

The outstanding balances of liabilities from related party transactions as at 31 December 2016 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Top management | - | 96 | - | 57 |
| KBC Bank | 3,219 | 200,717 | 8,616 | - |
| Entities under common control | | | | |
| ČSOB SK | 4 | 42 | - | - |
| KBC Investment Limited | 35 | 182 | - | - |
| KBC Securities NV | 111 | - | - | 1 |
| Other | 12 | 92 | - | 37 |
| Associates | | | | |
| ČSOB AM | - | 594 | - | 9 |
| ČSOB Pojišťovna | 21 | 2,594 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 7,545 | - | - |

The outstanding balances of financial assets and liabilities held for trading comprise positive and negative fair values of derivative financial instruments (mainly single currency and cross-currency interest rate swaps). Majority of these transactions are collateralised by cash deposit or by securities. Loans and receivables from related parties represent balances on current accounts. Financial liabilities to related parties measured at amortised cost consist of balances on demand deposits. Liabilities to KBC Bank NV represent balances on money-market products, specifically promissory notes with maturities up to one year issued by the Bank, repo transactions and short-term deposits.

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:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| (CZKm) | Interest income | Interest expense | Interest income | Interest expense |
| Directors / Top management | - | - | - | - |
| KBC Bank | 2,248 | 1,147 | 1,106 | 683 |
| Entities under common control | | | | |
| ČSOB SK | - | 3 | 3 | 1 |
| Other | 2 | - | 2 | - |
| Associates | | | | |
| ČSOB Pojišťovna | - | 36 | - | 38 |
| Joint ventures | | | | |
| ČMSS | 7 | 123 | 1 | 122 |

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

| | 2017 | | 2016 | |
|---|---|---|---|---|
| (CZKm) | Fee and commission income | Fee and commission expense | Fee and commission income | Fee and commission expense |
| KBC Bank NV | 64 | 2 | 83 | 1 |
| Entities under common control | | | | |
| ČSOB SK | - | - | - | 5 |
| KBC Securities NV | 8 | 37 | 18 | 32 |
| Other | - | 1 | - | 4 |
| Associates | | | | |
| ČSOB AM | 557 | 40 | 466 | 39 |
| ČSOB Pojišťovna | 534 | 2 | 274 | 4 |
| Joint ventures | | | | |
| ČMSS | 5 | 14 | 14 | 41 |

Effective from 1 July 2009, the Group concluded a service level agreement on the provision of administration services, such as human resources and accounting services, with KBC Group. In 2017, the Group received income of CZK 63 m (2016: CZK 68 m) from the provision of administration services and paid expense of CZK 495 m (2016: CZK 609 m) for IT services, including rental expenses on information technologies.

In 2017, the Group received income of CZK 675 m (2016: CZK 569 m) from ČSOB SK and ČSOB Pojišťovna arising from providing services and support in the following areas such as: ICT services, electronic banking, cards, payment processing, financial management and risk management.

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

| | 2017 | | 2016 | |
|---|---|---|---|---|
| (CZKm) | Guarantees received | Guarantees given | Guarantees received | Guarantees given |
| KBC Bank NV | 2,444 | 194 | 2,222 | 194 |
| Entities under common control | | | | |
| ČSOB SK | 2,308 | 23 | 2,343 | 23 |
| Kereskedelmi és Hitelbank Rt. | 219 | 18 | 232 | 23 |

The outstanding balances of guarantees received from KBC Bank and the entities under common control principally comprise sub-participation arrangements and other compensation commitments.

## 39. EVENTS AFTER THE REPORTING PERIOD

There were no events after the reporting period.

## 40. RISK MANAGEMENT

### *40.1 Introduction*

Risk is an inherent part of the Group's activities, and risk and capital management is critical to the results of operations and financial condition of the Group.

The principal risks that the Group faces are credit risk, liquidity risk, operational and other non-financial risks, market risk subdivided into trading (trading portfolio) and non-trading (credit and investment portfolio) risks. The Group manages risk and capital through a system of ongoing identification, measurement and monitoring, subject to risk and capital limits and other controls. The Group primarily allocates capital to each subsidiary and business unit with the aim of achieving an acceptable balance between risk and return. The Group's risk and capital management system is based on a risk strategy determined by the Bank's Board of Directors and is consistent with the KBC Group's risk and business strategy, with a primary focus on the early identification and management of risks and trends.
The Group maintains and develops its risk and capital management system to meet its ongoing internal risk and capital management needs and to comply with all legal and other regulatory (capital) requirements, including Basel III, and the regulations of the CNB, European Central Bank (ECB), European Banking Authority (EBA) and other relevant bodies.

**Risk and Capital Management Organization**

***Main Principles of Risk and Capital Management Organization***

The Group's risk and capital management organization is based on the principle of segregating risk origination and acceptance from risk monitoring and control. The risk and capital management and control functions are designed to be exercised independently of the front office functions. Nevertheless, the front office is engaged in risk and capital management and control functions and is responsible in the first instance for risk control in all risk and capital management areas. The aim of risk and capital management at the Group is to closely cooperate with the business in achieving an acceptable balance between return and risk, as opposed to focusing solely on minimizing risks.

Risk and capital management within the Group is centralized at the ČSOB level. Nevertheless, each subsidiary, associate and joint venture of ČSOB also has a risk control and management unit, the responsibilities and size of which are tailored to the requirements applicable to that subsidiary under the Group's risk and capital management strategy and policies. Any decisions taken by the Group are considered by the subsidiaries, associates and joint ventures of ČSOB as recommendations and require final approval by the appropriate decision making bodies of these subsidiaries, associates and joint ventures, as applicable.

The risk and capital management governance model that was implemented within the Group in 2011 is based on the following general principles:

- the business, including both sales and credit departments, should be responsible in the first instance for risk and capital management, and must systematically take into account risk and capital management considerations into all its decisions;
- risk and capital management, and risk reporting, should be performed consistently within the entire KBC Group, including the Group, and management incentives should be linked to risk and capital adjusted measures, and aligned consistently within the entire KBC Group;
- the risk and capital management governance structure should be an independent and vertically integrated structure aimed at ensuring that risk and capital management considerations are properly reflected in the business decisions within the Group;
- risk and capital management should closely cooperate with the business with the aim of achieving an acceptable balance between return and risk, as opposed to focusing only on minimising risks;

- the Board of Directors should determine the risk appetite of the Group within which the business has the right to take risks and beyond which the Chief risk officer (CRO) can intervene; and
- the risk reporting processes should be uniform and insightful to allow for the adoption of risk and capital management decisions at both strategic and implementation levels.

The principles described above establish a governance structure, within which:

(i) the Board of Directors is responsible for determining the risk appetite of the Group, and capital allocation within the Group, by establishing measurable risk and capital parameters, which must be followed in all business activities,

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

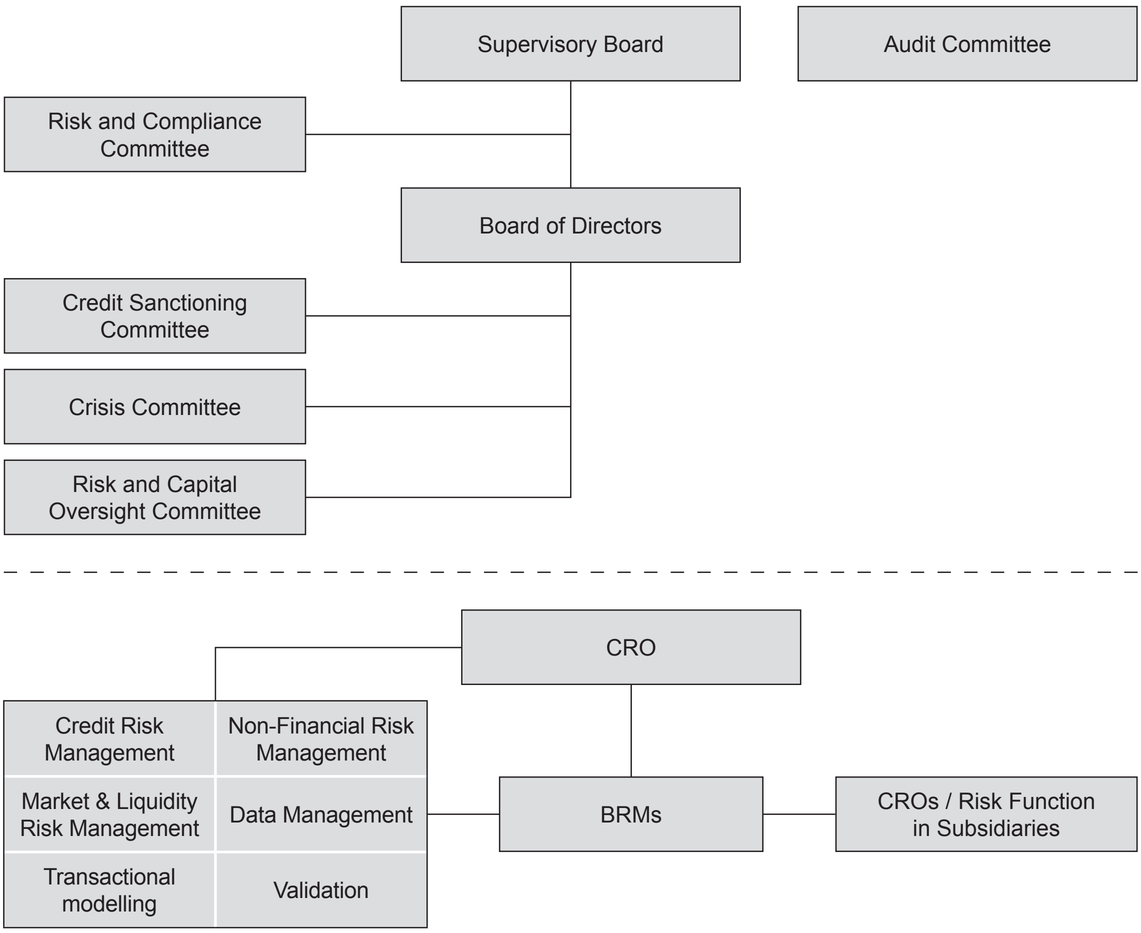
(iii) the CRO, together with the Risk Function, as described below, is responsible for designing the frameworks in which risk management should take place, for translating the risk limits into policies and for ensuring that monitoring systems are in place, and

(iv) the business is responsible for taking risks within the risk and capital allocation.

***Risk and Capital Management Governance***

Risk and capital governance in the Group is fully embedded in the governance of the KBC Group. During 2015, a few changes were put in place to take account of changes in the organisational structure of ČSOB. Most importantly, the Risk and Compliance Committee was established as a sub-committee of the Supervisory Board with a specific focus on risk management and compliance matters. In 2017, Transactional Modelling was newly incorporated into CRO zone.

The chart below depicts an overview of the principal bodies of the risk and capital governance model in the Group.



The Group operates a three-line of defense (LoD) risk management model whereby front office functions, risk management oversight and assurance roles are played by functions independent of one another. The model is characterised primarily by:

- the Board of Directors, assisted by the Audit Committee, Supervisory Board and its Committees,
- the Risk and Capital Oversight Committee,
- an independent Chief Risk Officer, supported by the independent Risk Function, and
- risk-aware business people, who act as the first line of defence ensuring that a risk control environment is established as part of day-to-day operations.

*Supervisory Board*

In its main role, the Supervisory Board oversees whether the governance of the Group is efficient, comprehensive and adequate, and regularly evaluates the findings obtained from this activity. Its oversight role consists in providing constructive challenge when developing the strategy of the Group; monitoring of the performance of the management function and the realisation of agreed goals and objectives, business and risk strategies; and ensuring the integrity of the financial information, effective risk management and internal controls (including proper segregation of duties within the Group).

The Supervisory Board regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

The Supervisory Board:

(i) Oversees whether the system of risk governance is efficient, comprehensive and adequate;

(ii) Regularly discuss matters concerning the risks to which the Bank is or might be exposed;

(iii) Continuously oversees and assures itself of the fulfilment of the risk management strategy and of the operational control's reliability;

(iv) Critically and constructively participates in the evaluation of the management of risks;

(v) Comments on a proposal (of the KBC Group CRO) to entrust as well as dismiss a natural person with the ensuring of the performance of the risk management function, stipulates policies governing remuneration of that person and assesses the activities of the person.

*Risk and Compliance Committee*

The Supervisory Board established the Risk and Compliance Committee which is mainly responsible for advising the Supervisory Board on the Group's overall current and future risk profile, appetite and strategy, and for overseeing the implementation of that strategy.

The Committee regularly discusses risk management and compliance related matters and communicates with the Group's risk control function and Chief Risk Officer. In addition, the Risk and Compliance Committee assists the Supervisory Board in the establishment of sound remuneration policies and practices, examines whether incentives provided by the remuneration system take into consideration risk, capital, liquidity likelihood and timing of earnings.

The Committee reviews the activities, structure, independence, professionalism and expertise of Risk management.

The Committee regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

*Audit Committee*

The Audit Committee, inter alia, monitors the effectiveness of the Group's internal control, internal audit, risk management systems, establishment of accounting policies by the institution and procedures in preparing the financial statements and consolidated financial statements of the Group.

With regards to external audit, the Committee oversees the Group's external auditors, monitors the process of mandatory audits of the financial statements and consolidated financial statements, assesses the independence of statutory auditors and the auditing firm(s), recommends for approval by the management body the appointment, compensation and appointment of the external auditors; review and approves the audit scope and frequency; review audit reports.

In addition to that the Committee checks that the management body in its management function takes necessary corrective actions in a timely manner to address control weaknesses, non-compliance with laws, regulations and policies, and other problems identified by the auditors.

*Board of Directors (BoD)*

The Board of Directors has the overall responsibility for the Group, proposes its strategic direction within applicable legal and regulatory framework taking into account the institution's long-term financial interests and solvency; ensures the effective implementation of the strategy and is responsible for the day-to-day running of the Group.

The Board of Directors generally ensures that comprehensive and adequate internal control and risk governance system is established, good functioning and efficient, in its entirety and in parts. With regards to the risk management function, the Board of Directors:

(i) Ensures earmarking of adequate and sufficient capacities for management of significant risks, capital and liquidity management, internal models and validations/reviews of such models;

(ii) Approves and regularly evaluates the implementation of:

- Risk Management Charter,
- Risk Appetite of ČSOB,
- Result of Risk Scan,
- Risk Management Strategy,
- Risk Management Framework (including risk specific frameworks),
- Limit Book and Framework,
- Internal Capital Adequacy Assessment Process and Capital Adequacy Policy,
- Recovery and Resolution plan,
- Information Security Strategy;

(iii) Evaluates the overall functioning and efficiency of the internal control and governance system (Internal Control Assessment to ČSOB Supervisory Board), and ensures appropriate steps to rectify the potential identified shortcomings.

On the basis of monthly integrated risk management reports prepared by the Risk Function, the Board of Directors is also responsible for monitoring whether the Group's risk profile is in line with the Group's risk appetite, limits system and making decisions on risk and capital management issues that may be escalated to its attention by the CRO or the RCOC, as described below.

*Risk and Capital Oversight Committee (RCOC)*

The RCOC assists the Board of Directors in monitoring the Group's risk and capital management exposures against the limits set by the Board of Directors. The key responsibilities of the RCOC regarding risk and capital management matters are to:

(i) propose to the Board of Directors the Bank's Risk Appetite;

(ii) propose to the Board of Directors a framework of limits consistent with the Bank's Risk Appetite, within which Risk and Capital will be managed;

(iii) provide an integrated view on Risk exposure against Risk Appetite/Limits and identify/report on 'hidden risks' (including concentration); In the event of Risk exposure being in excess of limit(s), to recommend to the BoD material mitigating actions and decide on non-material mitigating actions to bring Risk exposure back in line;

(iv) periodically review limits and, as necessary, to recommend to the BoD material changes in limit (s) and to decide on non – material limit changes;

(v) monitor market context, solvency, liquidity, risk/return profile, balance sheet profile, maturity transformation and structural interest rate exposure;

(vi) monitor capital adequacy and usage of Regulatory and Economic Capital.

The RCOC is responsible for the whole ČSOB group. In case of subsidiaries or entities that have a separate legal structure, the decisions of the RCOC are to be considered as advices to the Management Board of those entities.

The RCOC reviews regular risk reports prepared by the Risk Function, which are then submitted to the Board of Directors, the Audit Committee and the Supervisory Board. These reports form the basis for the risk monitoring process. Further ad hoc reports may be prepared and submitted, where relevant. The CRO is the chairman and the CFO is the vice-chairman of the Committee.

*Chief Risk Officer (CRO)*

The Chief Risk Officer (CRO), who is a member of the Board of Directors, is in general responsible for the identification, assessment and reporting of risks arising within operations across all business and all risk types, and has a direct management responsibility for the following risk management functions / departments:

(i) Credit Risk Management;

(ii) Market and Liquidity Risk Management;

(iii) Non-financial Risk Management;

(iv) Validations;

(v) Data Management; and

(vi) Transactional Modelling.

The CRO:

(i) Ensures that risk management processes are effective and efficient, promotes a culture of risk aware business conduct and prudent risk management;

(ii) Ensures compliance with Group (KBC) and regulatory requirements in the field of risk management;

(iii) Recommends the need for action to address risk & capital issues raised in internal reports;

(iv) Inputs to corrective actions to address local underperformance versus targets and agree to final actions to ensure within risk playing field;

(v) Assess the rate and structure of risk undertaken and the impact thereof on the performance and stability;

(vi) Coordinates the field of continuity management for the business;

(vii) Provides risk and capital reporting to internal (senior management, Board of Directors, Risk and Compliance Committee, Subsidiaries) and external clients (KBC, CNB);

(viii) Presents information concerning the developments in the field of risk management to ČSOB and KBC management;

(ix) Advices on risk related matters to Management Board of subsidiaries within the Group that have a separate legal structure;

(x) Is accountable for clear delineation of accountabilities and responsibilities between 3 LoD.

The key strategic and governance responsibilities of the CRO are to:

(i) Recommend Risk Governance structure and roles;

(ii) Decide the structure of the Risk Function;

(iii) Contribute to the Risk Appetite and approves Business line's Risk Appetites;

(iv) Contribute to the corporate Strategy / strategic plans (including performance targets) development and agree to final Strategy to ensure within risk playing field;

(v) Recommend Risk and Capital Adequacy Policy;

(vi) Contribute to limits and delegation of authority setting within and below BoD delegation and give consent to final decision to ensure within Risk Appetite;

(vii) Contribute to capital and funding allocation and give consent to final allocation to ensure staying within Risk Appetite.

The CRO, in its role has following key execution activities:

(i) Recommend and decide on changes to the Risk Function owned frameworks and policies;

(ii) Decide on validation of transactional models for risk management;

(iii) Input to guidelines for portfolio and transactional model development;

(iv) Input or decide (in line with the delegation rules) on mitigating actions for limit overruns and agree to final decision to ensure staying within Risk Appetite;

(v) Recommend and/or decide ex-post actions to address compliance issues with risk frameworks;

(vi) Ensure the process of assessment and evaluation of the regulatory / internally determined capital adequacy and conduct stress testing;

(vii) Contribute to day to day business decisions as a trusted advisor;

(viii) Agree to risk taking decisions outside of the risk playing field with the right to call “time out”.

The CRO may suspend any decisions of any department or committee, or any business unit or sub-unit, affecting the risk or capital position of the Group by escalating it to the RCOC or the Board of Directors.

*Risk Function*

The Risk Function provides independent oversight of the management of risks inherent in the Group’s activities. The function is generally responsible for ensuring that effective processes are in place for:

(i) Identifying current and emerging risks;

(ii) Developing risk assessment and measurement systems;

(iii) Establishing policies, practices and other control mechanisms to manage risks;

(iv) Developing risk tolerance limits for Senior Management and Board approval;

(v) Monitoring positions against approved risk tolerance limits; and

(vi) Reporting results of risk monitoring to Senior Management and the Board.

The Risk Function is represented by the following departments reporting to the CRO - Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management, Data Management, Validations and Transactional Modelling. The departments have the following roles:

*Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management*

Particular risk management departments are responsible for managing credit risk, market risk, liquidity risk and operational risk. The risk departments have the following roles and responsibilities:

(i) Define the risk management approach and methodology related to their specific risk type, in particular through ownership of the risk type specific framework and policies;

(ii) Define the risk measures that relate to the specific risk types;

(iii) Support ČSOB Group RCOC;

(iv) Support the CROs for all matters that relate to the specific risk types;

(v) Contribute to integrated processes (e.g. ICAAP/ORSA, stress testing);

(vi) Define and deliver the core reports for the specific risk types and deliver inputs for Integrated Risk Report;

(vii) Define and monitor a set of Limits (Primary & Secondary), Targets and indicators (e.g. Early Warning Signals) that cover the specific risk types;

(viii) Follow up on the status of risk and capital management for the specific risks throughout the ČSOB Group.

*Data Management*

Data Management is responsible for supporting all the other departments forming the Risk Function in data management and reporting. In particular:

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

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

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

Data Management is responsible for risk data governance and also forms the link between the requirements of the Risk Function and ICT.

*Central Credit risk and loss Measurement Validation*

Central Credit risk and loss Measurement Validation focuses on reducing of model risk and seeks a group-wide consistency by providing a well-founded, intelligible and timely independent second opinion and methodological guidance on models for risk measurement and provisioning to their owners, decision bodies and modellers.

*Transactional modelling*

Transactional modelling being part of KBC Group Modelling Competence Centre is responsible for design and review of local credit risk (PD, EAD, LGD), incl. application scorecards, and local provisioning models. The unit further participates in implementation of local and group-wide models into credit decision process of all business segments and for the purpose of regulatory capital calculation.

*Integrated risk management*

Furthermore, specific team within the Risk Function covers overarching aspects of risk management. It's mandate is to provide an increased focus on holistic risk management and cross-risk oversight to further enhance our risk management. Key objectives are to:

(i) drive key strategic cross-risk initiatives and establish greater cohesion between defining portfolio strategy and governing execution, including regulatory adherence and recovery planning;

(ii) provide a strategic and forward-looking perspective on the key risk issues for discussion at senior levels within the Group (risk appetite, stress testing framework);

(iii) strengthen risk culture at the Group; and

(iv) foster the implementation of consistent risk management standards.

Integrated risk management is responsible for managing the process of measuring and monitoring risk on an integrated basis within the Group. In particular, Integrated risk management performs the ICAAP process (see ICAAP Process below), including the management of economic capital, and is responsible for integrated risk reporting (see Risk Monitoring and Reporting below). Integrated risk management also regularly provides reports to the supervisory section of the CNB.

Integrated risk management is also responsible for preparation of recovery plans and cooperates with regulator in preparation of resolution plan.

*Delegation of responsibilities*

The Board of Directors has delegated responsibilities to each of the RCOC and the CRO.

Usage of delegation authority:

- can always be overruled by a higher decision level;
- is always restricted in time:
  (i) Either for a period explicitly mentioned in the Limit Book & Limit Framework
  (ii) If no time period is specified, until the next formal limit review
- always needs to be formally recorded ("audit trail") and communicated to Risk Management and CRO.

The RCOC and the CRO may authorize transactions and approve risk limit exceptions described in limit book and limit book framework. The limit book and limit book framework is regularly approved by RCOC and Board of Directors.

Moreover, the CRO may submit to the Board of Directors, the Supervisory Board, the Risk and Compliance Committee and/or the Audit Committee issues and concerns related to the entire Group which the CRO considers to have an actual or potential material impact on the Group's risk parameters.

In addition to the risk and capital management activities performed at the Group level, each subsidiary of ČSOB also has a risk control and management unit, the responsibilities of which are tailored to the requirements applicable to the subsidiary, under the Group's risk and capital management policies.

***Other Departments and Committees Participating in Risk and Capital Management***

In addition to the Board of Directors, the Audit Committee, the Supervisory Board, the RCOC, the CRO and the Risk Function, the following other departments and committees are involved in day-to-day risk and capital management at the Group level:

*Credit Departments*

The Credit Departments are responsible for implementing and maintaining the individual credit processes within the frameworks designed by the Risk Function and the limits determined by the risk appetite and capital allocation approved by the Board of Directors.

The Credit 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 (ALM Department)*

The ALM Department 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 ALM Department is also primarily responsible for managing the funding and liquidity position of the Group. The ALM Department reports to the CFO.

*Internal Audit Department*

The Internal Audit Department regularly audits / assesses risk and capital management processes throughout the Group examining both the adequacy of its risk and capital management procedures and the Group's compliance with the same. The Internal Audit Department discusses the results of its assessments with management, and reports its findings and recommendations to the Board of Directors and the Audit Committee. The Internal Audit Department reports to the CEO.

*New and Active Product Processes (NAPPs)*

Members of NAPP process are responsible for the approval of new products and their distribution and marketing, as well as for the regular review of existing products. Cross functional membership in NAPPs including control functions (the Risk Function, Finance Department, Tax Department, Legal Department and Compliance Department) seeks to ensure that no product may be offered to the Group's customers unless all significant risks have been analysed and mitigated and residual risks have been accepted. The Group pays special attention to protecting the Group against claims arising from the mis-selling of products. As a general rule, all products as well as all distribution channels must be covered by a NAPP.

*Credit Sanctioning Committee (CSC)*

The CSC is a committee with group-wide responsibility and authority to take decisions on individual credit applications falling within the delegated decision powers of the CSC. As such, it acts as the highest decision-making committee for the Group with respect to credit risk. The members of the CSC are the CFO, who is the CSC's chairman, and the head of the ČSOB credit and bad debts department, corporate advice and underwriting department, corporate and bank credits department, corporate specialised finance department and corporate and institutional banking department. The CSC reports to the Board of Directors.

***Business Risk Meetings (BRMs)***

Business Risk Meetings are established for each business line in the Group where business specific risk issues are regularly discussed. The CRO has sole decision right within the delegated decision authority which can always be escalated to the Board of Directors at the request of the Board of Directors' member responsible for that area.

***Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP)***

The Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) require banks to have in place processes to assess and maintain adequate levels of internal capital and liquidity buffers

The ICAAP is seen as an integral part of the overall management and control system of the Group, by which ČSOB also adopts and uses reliable, effective and comprehensive strategies and procedures to:

- continually set and assess the need for internal capital; and
- plan and maintain internal capital resources, of the amount, structure and allocation to sufficiently cover the risks that ČSOB is or may be exposed to (internally set and maintained capital adequacy).

As part of the KBC group, ČSOB has adopted a unified KBC group ICAAP approach, approved by the top managements of both KBC and ČSOB, taking into account requirements of the home regulator (the Czech National Bank) as well as the host regulator (the European Central Bank).

Regularly, at least once a year, the Board of Directors evaluates the ICAAP, focusing on an overall assessment of whether the strategies and procedures used are reliable, effective, comprehensive and still proportionate to the nature, scale and complexity of the Group's activities. The Board of Directors also discusses and approves any ICAAP changes and modifications. Moreover, results of Internal Capital Model which is currently used for internal calculation of the ČSOB capital adequacy are quarterly reported to the Board of Directors.

When setting and assessing - on an ongoing basis - its internal capital needs, and planning and maintaining its internal capital resources, ČSOB uses an accounting-value approach, while taking into account quantitative and qualitative inputs and methods, including its own expert analyses, forecasts and scenarios proportionate to the nature, scale and complexity of its activities and the risks associated with them.

ICAAP is forward looking, i.e. it also takes into account the risks to which the Group will or may be exposed. Therefore, ČSOB also assesses and takes into account, under the ICAAP the following:

- the processes of planning, preparing and approving new activities, products or systems;
- other ongoing or anticipated material changes in its risk profile or in the external environment;
- effects of possible divergences from the anticipated developments, including the effects of possible extraordinary circumstances; and
- stress test results;

including the methods of reflecting these when planning and securing internal capital resources. The ICAAP strategic planning horizon is three years.

ICAAP and ILAAP addresses the following material risks to which the Group is or may be exposed:

- Credit and counterparty risk, (incl. concentration risk)
- Interest rate in banking book
- Market risk banking book (excl. interest rate)
- Market risk trading book
- Operational risk

- Business and strategic risk
- Funding and liquidity risk

Other risks are covered, under ICAAP processes, by qualitative measures in risk management, organisation of processes, control mechanisms, etc.

The amount of capital needed is calculated for the Group as a separate entity within the KBC group at a probability level of 99.9% for a one year period, taking into account relevant diversification effects. The internally defined capital resources must fully cover the total capital need and, if compliance with this condition was at risk, ČSOB, in cooperation with the KBC group, would take relevant remedial measures (increasing capital resources, reducing risk, etc.).

According to the relevant EBA Guidelines the Internal Liquidity Assessment Process (ILAAP) is a process to identify, measure, manage and monitor liquidity, implemented by the bank pursuant to the CRD IV. It discloses all the qualitative and quantitative information about the systems, processes and methodologies to measure and manage liquidity and funding risk, which is necessary to underpin the risk appetite and business strategy both in normal and stressed scenarios.

**Risk measurement and reporting systems**

The Group's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Group also runs worse case scenarios that would arise when extreme events that are unlikely to occur do, in fact, occur.

Monitoring and controlling of risks is primarily performed based on limits established by the Group. These limits reflect the business strategy and market environment of the Group as well as the level of risk that the Group is willing to accept, with additional emphasis on selected industries. In addition, the Group monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all businesses is examined and processed in order to analyse, control and identify risks when they arise. This information is presented and explained to the Board of Directors, the RCOC, and the CRO. The reports include aggregate credit exposure, credit metric forecasts, hold limit exceptions, Value at Risk (VaR), interest rate sensitivities, interest rate gaps, liquidity ratios and risk profile changes. Once a quarter, the Supervisory Board receives a comprehensive risk report designed to provide all information necessary to assess and conclude on the risks of the Group.

A daily report is provided to top management and all other relevant members of the Group on the use of market limits and analysis of VaR in the trading book. A weekly report is provided to top management and all other relevant members on interest rate sensitivities and liquidity in the non-trading book.

**Risk mitigation**

As part of its overall risk management, the Group uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Group. The effectiveness of hedges is assessed by the Middle Office. The effectiveness of all hedge relationships is monitored by the unit quarterly. In situations of ineffectiveness, a new hedge relationship to mitigate risk on a continuous basis is established.

**Excessive risk concentration**

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Group's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Group's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. To prevent and manage excessive risk concentration at both a relationship and industry level, the Group, for selected cases, uses credit risk transfer instruments (e.g. risk sharing participation, risk transfer guarantees, etc).

## *40.2 Credit risk*

Credit risk is the risk of a potential loss expected to arise as a consequence of the non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to a commercial transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay, or to events or measures taken by the political or monetary authorities of a particular country. The latter is also referred to as country risk.

The Group manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations. The Group monitors exposures in relation to these limits. The Group has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties. This includes also regular collateral revisions.

Since September 2012, the Group is allowed by both Belgian and Czech banking regulators to use the IRB Advanced approach for the capital calculations of its non-retail (Corporate, non-retail SME, Banks, Non-Banking financial institutions) as well as retail exposures. As a result, credit risk is measured, monitored and managed based on the principles of this approach.

For the non-retail exposure (Corporate, non-retail SME, Banks, Non-Banking financial institutions), counterparty risk (i.e. default risk) is managed based on statistical default prediction models that establish a rating (PD / Probability of Default), LGD (Loss Given Default) and EAD (Exposure at Default).

For the retail exposures, statistical models have been developed for PD, LGD and EAD. Contrary to the non-retail exposure, where risk factors are determined on an individual basis, risk factors are determined in Retail based on risk-homogenous sets of exposure (so-called pools).

The model results are used for the capital calculation and for credit decision purposes too.

The default is defined as a situation where at least one of the following conditions is met:

(i) it may be assumed that the customer will not fulfil its obligations in a proper and timely manner without the Group seeking to collect its outstanding receivable through credit protection;

(ii) at least one payment of the principal or interest and fees of any obligation of the customer towards the Group is more than 90 days past the due date.

At ČSOB Group, default status is determined to occur any time a forbearance measure-concession is granted: forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. For more, see the section "Forbearance measures".

**Non-retail exposure**

*Rating system: PD (Probability of Default)*

The Group manages its non-retail credit exposure by establishing counterparty limits that are based on individually assigned internal ratings. These ratings are based on IRB Advanced compliant statistical rating models that take into account financial and non-financial data. The individual PD rating is scaled according to the KBC master scale, which has 12 grades going from PD 1 - the best rating to PD 12, which is the worst.

PD 1 to PD 9 represent the performing exposures.

PD 10 contains: (i) customers where the relevant Group credit decision authority has judged the exposure to be 'unlikely to pay' and none of the obligations are more than 90 days overdue; and (ii) restructured loans. After at least twelve months of performance, the restructured loan may be reclassified to the performing status; and (iii) previously restructured loans already classified as performing less than two years ago which become more than 30 days overdue.

PD 11 represents customers, who have been overdue for 90 days or more, but not subject to bankruptcy proceeds yet.

PD 12 represents customers, which are subject to bankruptcy proceeding or Group credit decision authority has judged the exposure to be 'partly or fully lost' without recourse to credit protection.

PD ratings are used not only for the measurement, monitoring and management of credit risk, but also to determine, among other things, the level at which a credit approval must be obtained, the required collateral and pricing.

The following table sets forth a breakdown of the Group's risk categories, including internal and external ratings, for non-retail exposure, and their comparison to the CNB's risk categories:

| 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 | Collectively assessed | Non-defaulted | Standard |
| Asset Quality review (AQR) | 8-9 | (B-) - C | Performing customers | Collectively assessed | Non-defaulted | Watched |
| Uncertain | 10 | D | Non-performing customers | Individually impaired | Defaulted | Substandard |
| Uncertain | 11 | D | Non-performing customers | Individually impaired | Defaulted | Doubtful |
| Irrecoverable | 12 | D | Non-performing customers | Individually impaired | Defaulted | Loss |

*Individual Credit Processes*

The individual approval, monitoring and work-out processes are subject to risk and capital management frameworks approved by the Group Risk Management (GRM) and/or the CRO but developed, maintained and implemented by the Credit Departments in the Group. These Credit Departments are also responsible for the implementation of these frameworks in the day-to-day operations of the credit processes and for assuring that individual risk acceptance remains within the limits set by the risk appetite statement.

*Application Process*

The loan or credit application process for non-retail credit exposures involves three steps. Firstly, the employee maintaining the overall relationship with the customer prepares a credit application containing the credit request, the reason for the application and an analysis of the risks (including a financial analysis). Secondly, a credit risk advisor operating independently from the business line, who reports to the Credit Department, provides a written non-binding advice. Thirdly, a decision is taken by the Credit Sanctioning Committee (CSC), the highest local decision taking body, or one of its sub-committees consisting of business line employees and employees in the Credit Department. The Committee adopts its decisions by consensus based on a draft decision formulated by the Chairman or Vice - Chairman.

Within the delegation framework set by the Group, the Credit Department can delegate the credit decision to the regional manager or senior relationship manager of a branch. Delegations are granted *ad personam*. The delegations are risk based and take into account the total exposure with respect to a customer or customer group.

All credit decisions must be taken according to the "four eyes principle", i.e. at least two persons with appropriate delegation authority need to be involved.

*Individual Monitoring Process*

An individual credit monitoring process is applicable to non-retail exposures (corporate, large non-retail SME). For small non-retail SME, an automated behavioural monitoring process is being used. Credit exposures with a rating between PD 1 – 8 (non-retail SME) / PD 1 – 9 (corporate) are reviewed by the business function with the support of monitoring applications. Credit exposures with a rating between PD 9 – 12 (non-retail SME) / PD 10 – 12 (corporate) are reviewed by the Bad Debt Department, which is a sub-department of the Credit Departments.

Regardless of the PD rating, a full credit application must be submitted to the applicable decision authority for a review at least once a year in accordance with the same application process as for the new exposures. Additionally, certain triggers lead to a more frequent review of credit applications. These triggers include breaches of contractual conditions (such as the breach of financial or non-financial covenants or the non-payment of fees, interest or principal), but also events that do not constitute a breach of contract such as a sudden unexpected change in management that could lead to a deterioration of the customer's financial situation.

In addition to the annual review process, commercial real estate finance, acquisition finance and project finance are subject to a quarterly review by the CSC, pursuant to which all major exposure is subject to a short review of its main credit risk characteristics. Based on the outcome of the general quarterly review, the CSC can take immediate action or request an early full review of the file.

*Collective Monitoring Process*

In addition to the required annual review process, a collective monitoring process is applied to non-retail SME customers. The monitoring of compliance by the customer with covenants specified in the relevant financing documentation is based on information provided by the customer in covenant compliance reports and financial statements. A breach of the internal thresholds and covenants specified in the financing documentation triggers the individual review process as described above.

*Bad Debts Treatment*

For both corporate and non-retail SME customers, the management of bad debts is the sole responsibility of the Bad Debt Department. The credit customer relationship is transferred to the Bad Debt Department when an exposure reaches a PD rating of 9 in the case of non-retail SME and PD rating of 10, in the case of corporate customers.

**Retail exposure (Entrepreneurs, retail SMEs and Individuals)**

*Risk Categories*

The following table sets forth a breakdown of the Group's risk categories for retail exposure and their comparison to the CNB's risk categories:

| ČSOB risk categories for Retail exposure | | | | ČSOB and CNB risk categories | CNB risk categories |
|---|---|---|---|---|---|
| PD Scale | Days overdue | Performance | Impairment | | |
| Normal | 0 - 30 | Performing | Collectively assessed | Non-defaulted | Standard |
| Asset Quality review (AQR) | 31 - 90 | Performing | Collectively assessed | Non-defaulted | Watched |
| Uncertain | 91 - 180 | Non-performing | Individually impaired | Defaulted | Substandard |
| Uncertain | 181 - 360 | Non-performing | Individually impaired | Defaulted | Doubtful |
| Irrecoverable | 360 and more | Non-performing | Individually impaired | Defaulted | Loss |

In addition, all restructured exposures fall initially within the non-performing category irrespective of whether or not they are overdue. After at least twelve months of performance the restructured exposures may be reclassified to the performing status.

Previously restructured exposures already classified as performing less than two years ago, can fall again into non-performing category when becoming more than 30 days overdue.

*Application Process*

The application process in the retail segment is based on the usage of application scorecards for new customers and behavioural scorecards for existing customers. For consumer finance products (personal unsecured loans, retail overdrafts and credit cards) decisions are fully automated based on scorecards in the vast majority of cases. Mortgage decisions are supported by scorecards but decision-taking is essentially manual.

The application process makes extensive use of several external credit bureau databases that include both positive and negative information.

*Monitoring Process*

The monitoring process in the retail segment is performed regularly by the relevant Credit Departments. It is based on aggregated data. It does not involve individual reviews and looks at the development of defaults and probability of default within different sub-portfolios and development of Credit Cost Ratios within the different sub-portfolios. The development of the mortgage portfolio is monitored also on the basis of pool migration (i.e. migration between different risk pools).

*Collection Process*

The collection process in retail consists of two major phases: early collection and late collection. Early collection is generally based on a rapid succession of reminders (via a call centre or automated written notices) starting when any payment is three days overdue and may involve the restructuring of the loan. Late collection is focused on legal proceedings and the recovery of collateral. In addition, mortgage collection also uses field collection for customers whose payments are less than 180 days overdue and which precedes late collection. Collection units within the Group are monitored by the Risk Function.

**Derivative financial instruments**

Positive fair values arising from financial derivative instruments entered into by the Group, such as foreign exchange derivatives and interest rate swaps, give rise to potential future claims resulting from counterparty default and are therefore treated for credit risk purposes in the same way as credit exposures.

**Credit-related commitments risk**

The Group provides guarantees and letters of credit on behalf of its customers, as a result of which the Group may be required to make payments on such customers' behalf. Such payments are subsequently required to be reimbursed to ČSOB by the customer based on the terms of the underlying credit documentation. These guarantees expose the Group to similar risks as loans and such risks are managed using the same credit risks control processes and policies.

The following two main commitment risks are treated as off-balance sheet within the Group:

(i) *Undrawn but Committed Exposure*. This exposure arises when the Group has a legal commitment to provide a borrower with a facility or credit when asked and such facility or credit has not yet been drawn. This type of exposure comprises to a large extent of short-term exposure, where the Group's commitment has a duration equal to or shorter than one year.

(ii) *Off-Balance Sheet Products*. This exposure consists of bank guarantees and/or letters of credit. Off-balance sheet products are granted predominantly in the corporate segment and often consist of bid, performance or advance payment bonds for domestic construction companies.

Commitment risks expose the Group to similar risks as loans and such risks are monitored and managed using the same credit risk control processes and policies.

The Group manages credit risk in three major portfolios: Credit portfolio, Investment portfolio and Trading portfolio. Besides these there is a credit exposure connected with settlement activities (correspondent banking, settlement of receivables generated within system of electronic toll, which ČSOB administers for the Czech Government - e-Toll), where the risk is limited as counterparties are either highly rated banks, government institutions or entities with guarantees by highly rated banks.

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2017. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash, balances with central banks and other demand deposits (Note: 16) | - | 43,849 | - | 905 | 44,754 |
| Financial assets held for trading | - | 233 | 16,012 | - | 16,245 |
| Financial assets held for trading pledged as collateral | - | - | 2,097 | - | 2,097 |
| Available-for-sale financial assets | 563 | 28,919 | - | - | 29,482 |
| Available-for-sale financial assets pledged as collateral | 1,772 | 4,075 | - | - | 5,847 |
| Loans and receivables | 581,906 | 477,479 | - | 2,816 | 1,062,201 |
| Held-to-maturity investments | 834 | 85,770 | - | - | 86,604 |
| Held-to-maturity investments pledged as collateral | - | 29,017 | - | - | 29,017 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (4,298) | - | - | (4,298) |
| Derivatives used for hedging | - | 9,113 | - | - | 9,113 |
| Other assets (Note: 25) | - | - | - | 1,397 | 1,397 |
| Total | 585,075 | 674,157 | 18,109 | 5,118 | 1,282,459 |
| Contingent liabilities (Note: 35) | 33,513 | - | - | 323 | 33,836 |
| Commitments – irrevocable (Note: 35) | 125,443 | - | - | - | 125,443 |
| Total | 158,956 | - | - | 323 | 159,279 |
| **Total credit risk exposure** | **744,031** | **674,157** | **18,109** | **5,441** | **1,441,738** |

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2016. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash, balances with central banks and other demand deposits (Note: 16) | - | 48,092 | - | 1,029 | 49,121 |
| Financial assets held for trading | - | 450 | 18,990 | - | 19,440 |
| Financial assets held for trading pledged as collateral | - | - | 568 | - | 568 |
| Available-for-sale financial assets | 1,433 | 52,428 | - | - | 53,861 |
| Available-for-sale financial assets pledged as collateral | 1,054 | 2,023 | - | - | 3,077 |
| Loans and receivables | 540,647 | 237,579 | - | 3,873 | 782,099 |
| Held-to-maturity investments | 834 | 115,792 | - | - | 116,626 |
| Held-to-maturity investments pledged as collateral | - | 16,053 | - | - | 16,053 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 852 | - | - | 852 |
| Derivatives used for hedging | - | 11,656 | - | - | 11,656 |
| Other assets (Note: 25) | - | - | - | 1,593 | 1,593 |
| Total | 543,968 | 484,925 | 19,558 | 6,495 | 1,054,946 |
| Contingent liabilities (Note: 35) | 31,335 | - | - | - | 31,335 |
| Commitments – irrevocable (Note: 35) | 118,292 | - | - | - | 118,292 |
| Total | 149,627 | - | - | - | 149,627 |
| **Total credit risk exposure** | **693,595** | **484,925** | **19,558** | **6,495** | **1,204,573** |

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) | 2017 Gross maximum exposure | 2017 Financial effect of collateral | 2017 Net maximum exposure | 2016 Gross maximum exposure | 2016 Financial effect of collateral | 2016 Net maximum exposure |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash, balances with central banks and other demand deposits (Note: 16) | 44,754 | - | 44,754 | 49,121 | - | 49,121 |
| Financial assets held for trading | 16,245 | 1,584 | 14,661 | 19,440 | 669 | 18,771 |
| Financial assets held for trading pledged as collateral | 2,097 | - | 2,097 | 568 | - | 568 |
| Available-for-sale financial assets | 29,482 | - | 29,482 | 53,861 | - | 53,861 |
| Available-for-sale financial assets pledged as collateral | 5,847 | - | 5,847 | 3,077 | - | 3,077 |
| Loans and receivables | 1,062,201 | 879,131 | 183,070 | 782,099 | 617,762 | 164,337 |
| Held-to-maturity investments | 86,604 | - | 86,604 | 116,626 | - | 116,626 |
| Held-to-maturity investments pledged as collateral | 29,017 | - | 29,017 | 16,053 | - | 16,053 |
| Fair value adjustments of the hedged items in portfolio hedge | (4,298) | - | (4,298) | 852 | - | 852 |
| Derivatives used for hedging | 9,113 | 601 | 8,512 | 11,656 | 791 | 10,865 |
| Other assets (Note: 25) | 1,397 | - | 1,397 | 1,593 | - | 1,593 |
| Total | 1,282,459 | 881,316 | 401,143 | 1,054,946 | 619,222 | 435,724 |
| Contingent liabilities and Commitments – irrevocable (Note: 35) | 159,279 | 44,556 | 114,723 | 149,627 | 42,532 | 107,095 |
| **Total credit risk exposure** | **1,441,738** | **925,872** | **515,866** | **1,204,573** | **661,754** | **542,819** |

Financial effect of collateral represents a fair value of collateral received by the Group against a credit exposure limited to the outstanding amount of the exposure.

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

| **2017** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Mortgage loans | 282,379 | - | 25,802 | **308,181** | (1,938) | - | **306,243** |
| Consumer loans | 28,062 | 3 | 10,573 | **38,638** | (900) | (11) | **37,727** |
| SME | 86,224 | 3,704 | 32,594 | **122,522** | (3,631) | (98) | **118,793** |
| Leasing | 40,161 | - | 1,510 | **41,671** | (422) | - | **41,249** |
| Corporate | 150,587 | 30,119 | 55,042 | **235,748** | (1,744) | (345) | **233,659** |
| Factoring | 6,661 | - | - | **6,661** | (373) | - | **6,288** |
| Other | 32 | 70 | 5 | **107** | (23) | (12) | **72** |
| **Total credits** | **594,106** | **33,896** | **125,526** | **753,528** | **(9,031)** | **(466)** | **744,031** |

| 2016 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Mortgage loans | 256,689 | - | 21,762 | **278,451** | (2,562) | - | **275,889** |
| Consumer loans | 24,183 | 16 | 9,635 | **33,834** | (1,044) | (17) | **32,773** |
| SME | 82,271 | 3,418 | 29,984 | **115,673** | (3,673) | (118) | **111,882** |
| Leasing | 36,202 | - | 1,970 | **38,172** | (538) | - | **37,634** |
| Corporate | 149,098 | 27,668 | 54,296 | **231,062** | (1,851) | (85) | **229,126** |
| Factoring | 5,563 | - | - | **5,563** | (371) | - | **5,192** |
| Other | 28 | 465 | 645 | **1,138** | (27) | (12) | **1,099** |
| **Total credits** | **554,034** | **31,567** | **118,292** | **703,893** | **(10,066)** | **(232)** | **693,595** |

The following tables show a reconciliation of the allowances for impairment losses on loans and receivables for 2016 and 2017 by classes of financial instruments and by individual and collective impairment:

| (CZKm) | Mortgage loans | Consumer loans | SME | Leasing | Corporate | Factoring | Other | Total |
|---|---|---|---|---|---|---|---|---|
| **At 1 January 2016** | **3,125** | **1,183** | **3,804** | **487** | **1,960** | **369** | **31** | **10,959** |
| Net increase in allowances for credit losses (Note: 13) | 47 | (93) | 419 | 55 | 234 | 17 | (9) | 670 |
| (Write-offs) / Recoveries | (610) | (47) | (550) | (4) | (342) | (15) | 5 | (1,563) |
| Foreign currency translation | - | 1 | - | - | (1) | - | - | - |
| **At 31 December 2016** | **2,562** | **1,044** | **3,673** | **538** | **1,851** | **371** | **27** | **10,066** |
| Net increase in allowances for credit losses (Note: 13) | (45) | (139) | 219 | (82) | (57) | 3 | (5) | (106) |
| (Write-offs) / Recoveries | (579) | (5) | (257) | (34) | (23) | (1) | 1 | (898) |
| Foreign currency translation | - | - | (4) | - | (27) | - | - | (31) |
| **At 31 December 2017** | **1,938** | **900** | **3,631** | **422** | **1,744** | **373** | **23** | **9,031** |

| (CZKm) | Individual impairment | Collective impairment | Total |
|---|---|---|---|
| **At 1 January 2016** | **9,984** | **975** | **10,959** |
| Net Increase in allowances for credit losses (Note: 13) | 607 | 63 | 670 |
| (Write-offs) / Recoveries | (1,563) | - | (1,563) |
| Transfers | (20) | 20 | - |
| Foreign currency translation | 2 | (2) | - |
| **At 31 December 2016** | **9,010** | **1,056** | **10,066** |
| Net increase in allowances for credit losses (Note: 13) | 59 | (165) | (106) |
| (Write-offs) / Recoveries | (898) | - | (898) |
| Transfers | (31) | 31 | - |
| Foreign currency translation | (31) | - | (31) |
| **At 31 December 2017** | **8,109** | **922** | **9,031** |

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

| | 2017 | | 2016 | |
|---|---|---|---|---|
| Sector | Granted exposure (CZKm) | Percentage of total exposure | Granted exposure (CZKm) | Percentage of total exposure |
| Private persons | 342,069 | 45.4 | 307,920 | 43.8 |
| Services | 62,898 | 8.3 | 63,333 | 9.0 |
| Distribution | 60,978 | 8.1 | 57,760 | 8.2 |
| Commercial Real Estate | 49,111 | 6.5 | 46,682 | 6.6 |
| Automotive | 39,321 | 5.2 | 39,235 | 5.6 |
| Building and Construction | 36,313 | 4.8 | 37,153 | 5.3 |
| Machinery and Heavy Equipment | 17,811 | 2.4 | 17,163 | 2.4 |
| Oil, Gas and other Fuels | 15,849 | 2.1 | 19,922 | 2.8 |
| Metals | 14,620 | 1.9 | 13,758 | 2.0 |
| Electricity | 13,979 | 1.9 | 14,897 | 2.1 |
| Authorities | 12,239 | 1.6 | 13,681 | 1.9 |
| Finance and Insurance | 11,368 | 1.5 | 10,800 | 1.5 |
| Other sectors | 76,972 | 10.3 | 61,589 | 8.8 |
| **Total** | **753,528** | **100.0** | **703,893** | **100.0** |

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

| **2017** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 147,324 | - | - | (2) | **147,322** |
| Equity securities | 543 | - | - | (83) | **460** |
| Loans and receivables within investment portfolio | 473,180 | - | - | - | **473,180** |
| Derivatives used for hedging | 9,113 | - | - | - | **9,113** |
| Derivatives held for trading | 233 | - | - | - | **233** |
| Cash, balances with central banks and other demand deposits | 43,849 | - | - | - | **43,849** |
| **Total investment** | **674,242** | **-** | **-** | **(85)** | **674,157** |

| **2016** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 185,880 | - | - | - | **185,880** |
| Equity securities | 492 | - | - | (76) | **416** |
| Loans and receivables within investment portfolio | 238,526 | - | - | - | **238,526** |
| Derivatives used for hedging | 11,656 | - | - | - | **11,656** |
| Derivatives held for trading | 450 | - | - | - | **450** |
| Cash, balances with central banks and other demand deposits | 47,997 | - | - | - | **47,997** |
| **Total investment** | **485,001** | **-** | **-** | **(76)** | **484,925** |

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

| (CZKm) | 2017 Granted exposure (CZKm) | 2017 Percentage of total exposure | 2016 Granted exposure (CZKm) | 2016 Percentage of total exposure |
|---|---|---|---|---|
| Central banks | 518,313 | 76.9 | 283,000 | 58.3 |
| General government | 143,847 | 21.3 | 169,094 | 34.9 |
| Credit institutions | 11,335 | 1.7 | 32,380 | 6.7 |
| Corporate | 662 | 0.1 | 451 | 0.1 |
| **Total investment** | **674,157** | **100.0** | **484,925** | **100.0** |

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

| **2017** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 5,837 | - | - | **5,837** |
| Equity securities | 9 | - | - | **9** |
| Loans and advances | 39 | - | - | 39 |
| Derivatives held for trading | 12,224 | - | - | **12,224** |
| **Total trading portfolio** | **18,109** | **-** | **-** | **18,109** |

| **2016** (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 7,220 | - | - | **7,220** |
| Equity securities | 1 | - | - | **1** |
| Loans and advances | 170 | - | - | 170 |
| Derivatives held for trading | 12,167 | - | - | **12,167** |
| **Total trading portfolio** | **19,558** | **-** | **-** | **19,558** |

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

| Sector | 2017 Granted exposure (CZKm) | 2017 Percentage of total exposure | 2016 Granted exposure (CZKm) | 2016 Percentage of total exposure |
|---|---|---|---|---|
| General government | 3,144 | 17.4 | 4,527 | 23.2 |
| Credit institutions | 12,461 | 68.8 | 10,431 | 53.3 |
| Corporate | 2,504 | 13.8 | 4,600 | 23.5 |
| **Total trading portfolio** | **18,109** | **100.0** | **19,558** | **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:

| (CZKm) | 2017 Total risk | 2017 of which General government | 2016 Total risk | 2016 of which General government |
|---|---|---|---|---|
| Czech Republic | 1,359,445 | 136,912 | 1,188,550 | 160,464 |
| Slovak Republic | 17,197 | 7,126 | 20,595 | 8,041 |
| Belgium | 13,240 | 993 | 14,392 | 1,835 |
| Italy | 2,263 | - | 2,798 | - |
| Hungary | 1,113 | - | 630 | - |
| Spain | 132 | - | 125 | - |
| Greece | 13 | - | 15 | - |
| Other Europe | 42,299 | 8,859 | 42,128 | 10,661 |
| Other | 6,036 | - | 5,340 | - |
| **Total** | **1,441,738** | **153,890** | **1,204,573** | **181,001** |

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 | 2017 Granted exposure (CZKm) | 2017 Percentage of total exposure | 2016 Granted exposure (CZKm) | 2016 Percentage of total exposure |
|---|---|---|---|---|
| 1 largest client | 8,048 | 1.1 | 8,411 | 1.2 |
| 10 largest clients | 56,384 | 7.5 | 55,882 | 7.9 |
| 25 largest clients | 98,616 | 13.1 | 98,604 | 14.0 |

The largest exposures to single clients in the investment and trading portfolio as at 31 December 2017 and 31 December 2016 were:

| Client | 2017 Granted exposure (CZKm) | 2017 % of total investment portfolio | 2016 Granted exposure (CZKm) | 2016 % of total investment portfolio |
|---|---|---|---|---|
| ***Investment portfolio*** | | | | |
| Czech Ministry of Finance (S&P's rating AA) | 126,872 | 18.8 | 148,558 | 30.6 |
| CNB | 514,015 | 76.3 | 283,000 | 58.4 |
| ***Trading portfolio*** | | | | |
| Czech Ministry of Finance (S&P's Rating AA) | 3,144 | 17.4 | 4,527 | 23.1 |
| KBC Bank | 3,952 | 21.8 | 2,892 | 14.8 |

Exposures to counter parties by risk rating class in the investment and trading portfolio as at 31 December 2017 and 31 December 2016 were:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| Rating (S&P) | Granted exposure (CZKm) | % of total portfolio | Granted exposure (CZKm) | % of total portfolio |
| ***Investment portfolio*** | | | | |
| AAA up to and including A- | 665,841 | 98.7 | 473,712 | 97.7 |
| BBB+ up to and including BB- | 8,113 | 1.2 | 9,842 | 2.0 |
| Below BB- | - | - | - | - |
| Unrated | 203 | 0.1 | 1,371 | 0.3 |
| **Total** | **674,157** | **100.0** | **484,925** | **100.0** |
| ***Trading portfolio*** | | | | |
| AAA up to and including A- | 12,000 | 66.3 | 12,834 | 65.6 |
| BBB+ up to and including BB- | 3,534 | 19.5 | 2,203 | 11.3 |
| Below BB- | - | - | - | - |
| Unrated | 2,575 | 14.2 | 4,521 | 23.1 |
| **Total** | **18,109** | **100.0** | **19,558** | **100.0** |

### Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- For securities lending and reverse repurchase transactions, cash or securities;
- For commercial lending, pledges over real estate properties, trade receivables and inventory;
- For retail lending, pledges over residential properties are used for mortgage financing.

The Group continuously monitors the market value of all collateral, monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses and requests additional collateral in accordance with the underlying agreement when necessary. The amount of collateral reported for an individual receivable does not exceed the carrying amount of the receivable.

Within concluding derivatives transaction to hedge counterparty's risk the Group uses Master netting agreements and collateralisation annex (i.e. CSA or its equivalents).

### Impairment assessment

The main considerations for credit impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, worsening of their credibility reflected by credit rating downgrades or infringement of the original terms of the contract. The Group addresses impairment in two areas: specific impairments and impairments incurred but not reported (IBNR).

Specific impairments are applied to individual assets where there is registered objective evidence of default. All defaulted exposure requires an impairment test – when a client becomes defaulted, it is considered to be impaired and thus specific impairment has to be accounted for. IBNR are applied for asset groups that based on statistical evidence contain probably already impaired assets, but have not been yet individually recognised.

*Specific impairment (Individual assessment)*

The Group determines allowances appropriate for loans with outstanding amounts above a predefined materiality threshold where there is registered objective evidence of default on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of other financial support, liquidation value of collateral, and the timing of the expected cash flows. Impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention. For insignificant exposures with registered objective evidence of default, a portfolio approach for deriving the impairment allowance is applied using statistical methods and models.

*IBNR (Collective assessment)*

Collective allowances are applied for loans and advances where there has not yet been recognised objective evidence of impairment and they reflect impairment that is likely to be present in the group of assets. Collective allowances are assessed based on statistical estimates and evaluated at each reporting period.

Collective allowances are estimated by taking into consideration:

(i) historical losses in the portfolio;

(ii) current economic conditions;

(iii) the approximate delay between the time a loss is likely to have been incurred and the time it will be identified (emergence period).

The local management is responsible for deciding on the length of the emergence period. In 2014, the Group used a uniform emergence period of four months, which was confirmed by the back-testing. In 2015, the emergence period has been extended to 6 – 8 months for some of the segments based on the latest back-testing results and in 2016 further changes have been made for other segments, prolonging the emergence period also to 8 months. The emergence period extension resulted in 2016 and 2015 an increase of the collective impairment provision of CZK 160 m (2015: CZK 390 m). The back-testing methodology was refined in 2016 and 2015 following the updated Group policy on determining the emergence period and its back-testing. All 2016 emergence periods have been reconfirmed for 2017.

Financial guarantees and letters of credit are assessed and provisions are made for them in a similar manner as allowances for loans and other receivables.

**Quality of credit portfolio**

The Group sorts exposures into five categories for the purpose of credit risk management. The table below shows the credit quality by class of asset for loan-related statement of financial position lines (in gross amounts), based on the Group's credit rating system as at 31 December 2017 and 2016:

***Credit portfolio***

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Collectively assessed assets | | Individually impaired assets | | | Total |
| (CZKm) | Normal | AQR | Uncertain *(Substandard)* | Uncertain *(Doubtful)* | Irrecoverable | |
| Mortgage loans | 275,831 | 1,893 | 1,001 | 368 | 3,286 | 282,379 |
| Consumer loans | 26,970 | 153 | 27 | 196 | 716 | 28,062 |
| SME | 80,033 | 1,766 | 1,374 | 269 | 2,782 | 86,224 |
| Leasing | 38,697 | 691 | - | 370 | 403 | 40,161 |
| Corporate | 143,907 | 4,408 | 908 | - | 1,364 | 150,587 |
| Factoring | 5,883 | - | 654 | - | 124 | 6,661 |
| Other | - | 9 | - | 1 | 22 | 32 |
| **Total** | **571,321** | **8,920** | **3,964** | **1,204** | **8,697** | **594,106** |

| (CZKm) | 2016 Collectively assessed assets Normal | AQR | Individually impaired assets Uncertain *(Substandard)* | Uncertain *(Doubtful)* | Irrecoverable | Total |
|---|---|---|---|---|---|---|
| Mortgage loans | 248,637 | 2,106 | 1,145 | 464 | 4,337 | 256,689 |
| Consumer loans | 22,994 | 141 | 62 | 201 | 785 | 24,183 |
| SME | 75,526 | 2,112 | 1,416 | 338 | 2,879 | 82,271 |
| Leasing | 34,812 | 723 | - | 241 | 426 | 36,202 |
| Corporate | 141,421 | 4,240 | 1,892 | - | 1,545 | 149,098 |
| Factoring | 4,764 | - | 646 | - | 153 | 5,563 |
| Other | 3 | - | - | 1 | 24 | 28 |
| **Total** | **528,157** | **9,322** | **5,161** | **1,245** | **10,149** | **554,034** |

### *Investment portfolio*

| (CZKm) | 2017 Collectively assessed assets Normal | AQR | Individually impaired assets Irrecoverable | Total |
|---|---|---|---|---|
| Debt securities | 146,993 | 329 | - | 147,322 |
| Equity securities | 438 | - | 22 | 460 |
| Loans and receivables within investment portfolio | 473,180 | - | - | 473,180 |
| Derivatives used for hedging | 9,113 | - | - | 9,113 |
| Derivative contracts held for trading | 233 | - | - | 233 |
| Cash, balances with central banks and other demand deposits | 43,849 | - | - | 43,849 |
| **Total** | **673,806** | **329** | **22** | **674,157** |

| (CZKm) | 2016 Collectively assessed assets Normal | AQR | Individually impaired assets Irrecoverable | Total |
|---|---|---|---|---|
| Debt securities | 185,880 | - | - | 185,880 |
| Equity securities | 391 | - | 25 | 416 |
| Loans and receivables within investment portfolio | 238,526 | - | - | 238,526 |
| Derivatives used for hedging | 11,656 | - | - | 11,656 |
| Derivative contracts held for trading | 450 | - | - | 450 |
| Cash, balances with central banks and other demand deposits | 47,997 | - | - | 47,997 |
| **Total** | **484,900** | **-** | **25** | **484,925** |

### *Trading portfolio*

| (CZKm) | 2017 Collectively assessed assets Normal | Individually impaired assets Irrecoverable | Total |
|---|---|---|---|
| Debt securities | 5,837 | - | 5,837 |
| Equity securities | 9 | - | 9 |
| Loans and advances | 39 | - | 39 |
| Derivative contracts held for trading | 12,224 | - | 12,224 |
| **Total** | **18,109** | **-** | **18,109** |

| | 2016 | | |
|---|---|---|---|
| | Collectively assessed assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 7,220 | - | 7,220 |
| Equity securities | 1 | - | 1 |
| Loans and advances | 170 | - | 170 |
| Derivative contracts held for trading | 12,167 | - | 12,167 |
| **Total** | **19,558** | **-** | **19,558** |

The table below shows a credit quality analysis of gross exposures of collectively assessed financial assets in the Credit portfolio:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| (CZKm) | Neither past due nor individually impaired | Past due (< 30 days) but not individually impaired | Past due (> 30 days) but not individually impaired | Neither past due nor individually impaired | Past due (< 30 days) but not individually impaired | Past due (> 30 days) but not individually impaired |
| Mortgage loans | 270,028 | 6,376 | 1,320 | 242,212 | 7,020 | 1,511 |
| Consumer loans | 26,393 | 627 | 103 | 22,549 | 504 | 82 |
| SME | 80,966 | 769 | 64 | 76,613 | 956 | 69 |
| Leasing | 39,290 | 84 | 14 | 35,393 | 132 | 10 |
| Corporate | 148,315 | - | - | 145,661 | - | - |
| Factoring | 5,883 | - | - | 4,764 | - | - |
| Other | 9 | - | - | 3 | - | - |
| **Total** | **570,884** | **7,856** | **1,501** | **527,195** | **8,612** | **1,672** |

Collectively assessed assets reported within Neither past due nor individually impaired gross exposures consist of Normal risk category assets based on the Group's credit rating system.

There were no past due but not impaired assets in the Investment and Trading portfolios.

Gross amounts of individually impaired financial assets included in the credit portfolio and the related impairment are as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| (CZKm) | Gross amount | Impairment | Gross amount | Impairment |
| Mortgage loans | 4,655 | (1,728) | 5,946 | (2,307) |
| Consumer loans | 937 | (718) | 1,048 | (798) |
| SME | 4,425 | (3,298) | 4,633 | (3,336) |
| Leasing | 773 | (327) | 667 | (427) |
| Corporate | 2,273 | (1,662) | 3,437 | (1,767) |
| Factoring | 778 | (353) | 799 | (350) |
| Other | 24 | (23) | 25 | (25) |
| **Total** | **13,865** | **(8,109)** | **16,555** | **(9,010)** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Equity securities | 22 | 25 |
| **Total** | **22** | **25** |

### Forbearance measures

Forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. Contracts for which forbearance measures have been taken and for which the exit criteria are not fulfilled are referred to as "Forborne credits". Such an approach enables the Group to control and limit potential future losses stemming from troubled credits.

As a result of the update of the Definition of Default made by the Group, the Group's definition of default is aligned with the EBA definition of non-performing exposures (PD 10-11-12), meaning that from 2014 they are only to be seen as synonyms. Previously, only PD grades 11 and 12 fell within the 'non-performing' exposure category. The same holds for the definition of the individually impaired financial instrument according to IFRS.

The approved changes impacted the business of the Group in the following way. The minimum period for the default status for the forborne exposures has been extended from 6 to 12 months; following the conservative approach of the local regulator, default status occurs any time a forbearance measure-concession is granted. The minimum period for assignment of the 'Forborne tag' is therefore 36 months: this period consists of the 12 months of the default status, and 24 months of what is referred to as the 'probation period'. In addition, any time more than 30 days past due are observed at an individual receivable during the 'probation period', the receivable is re-classified as defaulted and the 36-month period is re-set.

Outstanding gross amounts and gross amounts of forborne exposures included in the credit portfolio and the related impairment and collateral and financial guarantees as at 31 December 2017 and 2016 are as follows:

| | 2017 | | | | |
|---|---|---|---|---|---|
| | | Forborne exposures | | | |
| (CZKm) | Outstanding gross amount | Exposure of collectively and individually assessed assets | Percentage of outstanding gross amount (%) | Individual and collective impairment | Collateral and financial guarantees |
| Corporate | 163,220 | 2,587 | 1.6 | 717 | 1,173 |
| SME | 94,677 | 1,058 | 1.1 | 650 | 200 |
| Mortgage loans | 282,379 | 2,001 | 0.7 | 221 | 1,782 |
| Other | 53,830 | 472 | 0.9 | 113 | 171 |
| **Total** | **594,106** | **6,118** | **1.0** | **1,701** | **3,326** |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | | Forborne exposures | | | |
| (CZKm) | Outstanding gross amount | Exposure of collectively and individually assessed assets | Percentage of outstanding gross amount (%) | Individual and collective impairment | Collateral and financial guarantees |
| Corporate | 162,312 | 2,766 | 1.7 | 755 | 1,219 |
| SME | 93,754 | 1,295 | 1.4 | 647 | 404 |
| Mortgage loans | 256,689 | 2,323 | 0.9 | 293 | 2,031 |
| Other | 41,279 | 429 | 1.0 | 109 | 105 |
| **Total** | **554,034** | **6,813** | **1.2** | **1,804** | **3,759** |

Detail analysis of forborne exposures included in the credit portfolio and the related impairment as at 31 December 2017 and 2016 are as follows:

| | 2017 | | | | |
|---|---|---|---|---|---|
| (CZKm) | Exposure of collectively assessed assets | Of which past due but not individually impaired assets | Exposure of individually impaired assets | Individual impairment | Collective impairment |
| Corporate | 1,694 | - | 893 | 713 | 4 |
| SME | 77 | 13 | 981 | 648 | 2 |
| Mortgage loans | 895 | 148 | 1,106 | 163 | 58 |
| Other | 142 | 11 | 330 | 112 | 1 |
| **Total** | **2,808** | **172** | **3,310** | **1,636** | **65** |

| | 2016 | | | | |
|---|---|---|---|---|---|
| (CZKm) | Exposure of collectively assessed assets | Of which past due but not individually impaired assets | Exposure of individually impaired assets | Individual impairment | Collective impairment |
| Corporate | 743 | 4 | 2,022 | 755 | - |
| SME | 229 | 28 | 1,066 | 642 | 5 |
| Mortgage loans | 889 | 148 | 1,435 | 229 | 64 |
| Other | 158 | 26 | 271 | 106 | 3 |
| **Total** | **2,019** | **206** | **4,794** | **1,732** | **72** |

The following table shows a reconciliation of gross amounts of forborne exposures for 2017 and 2016 by classes of financial instruments:

| (CZKm) | Corporate | SME | Mortgage loans | Other | Total |
|---|---|---|---|---|---|
| **At 1 January 2016** | **2,778** | **1,345** | **2,508** | **423** | **7,054** |
| Loans which have become forborne | 1,882 | 350 | 647 | 168 | 3,047 |
| Loans which are no longer considered to be forborne | (1,851) | (237) | (368) | (88) | (2,544) |
| Increase of exposure | 49 | 13 | - | - | 62 |
| Decrease of exposure | (92) | (176) | (469) | (74) | (811) |
| Other movements | - | - | 5 | - | 5 |
| **At 31 December 2016** | **2,766** | **1,295** | **2,323** | **429** | **6,813** |
| Loans which have become forborne | 36 | 318 | 411 | 355 | 1,120 |
| Loans which are no longer considered to be forborne | (9) | (294) | (311) | (115) | (729) |
| Increase of exposure | 9 | 1 | - | - | 10 |
| Decrease of exposure | (219) | (287) | (427) | (168) | (1,101) |
| Other movements | 4 | 25 | 5 | (29) | 5 |
| **At 31 December 2017** | **2,587** | **1,058** | **2,001** | **472** | **6,118** |

The following table shows a reconciliation of impairments of forborne exposure for 2017 and 2016 by classes of financial instruments:

| (CZKm) | Corporate | SME | Mortgage loans | Other | Total |
|---|---|---|---|---|---|
| **At 1 January 2016** | **737** | **593** | **321** | **117** | **1,768** |
| Loans which have become forborne | 61 | 148 | 74 | 41 | 324 |
| Loans which are no longer considered to be forborne | (92) | (73) | (19) | (22) | (206) |
| Increase of exposure | 63 | 92 | - | 12 | 167 |
| Decrease of exposure | (14) | (113) | (83) | (39) | (249) |
| **At 31 December 2016** | **755** | **647** | **293** | **109** | **1,804** |
| Loans which have become forborne | 12 | 160 | 36 | 58 | 266 |
| Loans which are no longer considered to be forborne | - | (71) | (10) | (2) | (83) |
| Increase of exposure | 4 | 63 | - | 11 | 78 |
| Decrease of exposure | (52) | (157) | (112) | (57) | (378) |
| Other movements | (2) | 8 | 14 | (6) | 14 |
| **At 31 December 2017** | **717** | **650** | **221** | **113** | **1,701** |

## *40.3 Liquidity risk and funding management*

Liquidity risk is the risk that the Group will not be able to efficiently meet both expected and unexpected current and future cash flows and collateral needs without normal business operations being disrupted. To limit this risk, the Group pays significant attention to both operational and strategic liquidity management.

**Operational Liquidity Management**

The aim of operational liquidity management is to ensure the smooth processing of the Group’s current payment obligations in CZK as well as in other currencies while minimizing associated cost. Operational liquidity is based on cash flow projections with an outlook of up to ten working days for CZK and one day for other currencies.

### Funding Management

The actual development of liquidity might vary from ALM's liquidity prediction. The Group can address an adverse liquidity development in several ways. Most typically, the Group would adjust its investment policy, i.e. decrease the percentage of liabilities reinvested in cash form and use the liquidity from maturing bonds for other purposes. In the event of a more sudden decrease of liquidity, the Group can borrow via repo operations on the market or use regulatory repo facilities (in the CNB or ECB). The capacity and readiness to withstand adverse liquidity development is regularly reviewed by the means of stress tests.

Starting from October 2015, the Group reports on Liquidity Coverage Ratio (LCR), which compares available liquidity buffers to expected net cash outflows within the 30 day horizon under gravely stressed conditions.

The LCR during 2017 and 2016 was as follows:

| (%) | 2017 | 2016 |
|---|---|---|
| 31 March | 145.9 | 161.6 |
| 30 June | 145.4 | 156.2 |
| 30 September | 147.7 | 161.3 |
| 31 December | 146.4 | 155.7 |

The LCR ratio is regularly monitored and reported to the top management of the Group.

### Strategic Liquidity Management

The aim of strategic liquidity management is to provide sufficient funding for the Group's business activities in the medium- and long-term horizon. For strategic liquidity management, the Group uses the net-stable-funding-ratio (NSFR) which is defined as a ratio of available stable funding (numerator) to required stable funding (denominator). The strategy of the Group is to maintain the value of the NSFR well above one. That means the Group aims to maintain matched funding, i.e. to ensure that long-term assets are funded by stable liabilities (contractually or statistically), while short-term liabilities are used for the funding of assets that are short-term and/or liquid.

The NSFR is monitored on a monthly basis and it is regularly reported to the top management of the Group.

The NSFR during 2017 and 2016 was as follows:

| (%) | 2017 | 2016 |
|---|---|---|
| 31 March | 143.5 | 149.0 |
| 30 June | 145.9 | 145.9 |
| 30 September | 149.5 | 149.5 |
| 31 December | 146.0 | 150.9 |

In addition to internally defined limits, the Group must also comply with a regulatory limit on the basis of mandatory minimum reserve 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 (outflows / inflows shown as negative / positive figures).

The following table sets out the financial liabilities of the Group by remaining contractual maturity as at 31 December 2017:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | **Total** |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading other than financial derivatives | - | (15,435) | (5,463) | (189) | (21,087) |
| Financial liabilities designated at fair value through profit or loss | - | (13) | (8,099) | (2,176) | (10,288) |
| Financial liabilities at amortised cost | (760,056) | (361,987) | (43,200) | (2,092) | (1,167,335) |
| Fair value adjustments of the hedged items in portfolio hedge | 3,803 | - | - | - | 3,803 |
| Other liabilities (Note: 28) | - | (4,938) | - | - | (4,938) |
| **Contractual cash flows excluding derivatives** | **(756,253)** | **(382,373)** | **(56,762)** | **(4,457)** | **(1,199,845)** |
| Net settled derivatives | - | (4,118) | (10,654) | (5,811) | (20,583) |
| Trading derivatives | - | (2,187) | (5,171) | (1,903) | (9,261) |
| Hedging derivatives | - | (1,931) | (5,483) | (3,908) | (11,322) |
| Gross settled derivatives | - | (4,007) | (2,792) | (267) | (7,066) |
| Trading derivatives | - | (3,877) | (2,557) | (267) | (6,701) |
| *Inflows* | - | *232,789* | *79,260* | *6,646* | *318,695* |
| *Outflows* | - | *(236,666)* | *(81,817)* | *(6,913)* | *(325,396)* |
| Hedging derivatives | - | (130) | (235) | - | (365) |
| *Inflows* | - | *2,833* | *7,668* | *555* | *11,056* |
| *Outflows* | - | *(2,963)* | *(7,903)* | *(555)* | *(11,421)* |
| **Contractual cash flows from derivatives** | **-** | **(8,125)** | **(13,446)** | **(6,078)** | **(27,649)** |
| **Contractual cash flows from financial liabilities** | **(756,253)** | **(390,498)** | **(70,208)** | **(10,535)** | **(1,227,494)** |
| Loan commitments – irrevocable (note 35) | (125,527) | - | - | - | (125,527) |
| Loan commitments – revocable (note 35) | (52,272) | - | - | - | (52,272) |
| Financial guarantees (note 35) | (32,879) | - | - | - | (32,879) |
| Other commitments (note 35) | (1,340) | - | - | - | (1,340) |
| **Contractual cash flows from contingent liabilities** | **(212,018)** | **-** | **-** | **-** | **(212,018)** |

The following table sets out the financial liabilities of the Group by remaining contractual maturity as at 31 December 2016:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | **Total** |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading other than financial derivatives | - | (18,744) | (6,522) | (2,278) | (27,544) |
| Financial liabilities designated at fair value through profit or loss | - | (57) | (1,212) | (308) | (1,577) |
| Financial liabilities at amortised cost | (657,638) | (241,035) | (26,561) | (6,171) | (931,405) |
| Fair value adjustments of the hedged items in portfolio hedge | (4,796) | - | - | - | (4,796) |
| Other liabilities (Note: 28) | - | (4,684) | - | - | (4,684) |
| **Contractual cash flows excluding derivatives** | **(662,434)** | **(264,520)** | **(34,295)** | **(8,757)** | **(970,006)** |
| Net settled derivatives | - | (6,040) | (9,814) | (3,882) | (19,736) |
| Trading derivatives | - | (3,338) | (5,875) | (2,077) | (11,290) |
| Hedging derivatives | - | (2,702) | (3,939) | (1,805) | (8,446) |
| Gross settled derivatives | - | (257) | (2,038) | (375) | (2,670) |
| Trading derivatives | - | (195) | (500) | (62) | (757) |
| *Inflows* | - | *68,584* | *43,569* | *21,548* | *133,701* |
| *Outflows* | - | *(68,779)* | *(44,069)* | *(21,610)* | *(134,458)* |
| Hedging derivatives | - | (62) | (1,538) | (313) | (1,913) |
| *Inflows* | - | *340* | *15,471* | *3,915* | *19,726* |
| *Outflows* | - | *(402)* | *(17,009)* | *(4,228)* | *(21,639)* |
| | - | | | | |
| **Contractual cash flows from derivatives** | **-** | **(6,297)** | **(11,852)** | **(4,257)** | **(22,406)** |
| **Contractual cash flows from financial liabilities** | **(662,434)** | **(270,817)** | **(46,147)** | **(13,014)** | **(992,412)** |
| Loan commitments – irrevocable (note 35) | (118,292) | - | - | - | (118,292) |
| Loan commitments – revocable (note 35) | (44,732) | - | - | - | (44,732) |
| Financial guarantees (note 35) | (30,243) | - | - | - | (30,243) |
| Other commitments (note 35) | (1,324) | - | - | - | (1,324) |
| **Contractual cash flows from contingent liabilities** | **(194, 591)** | **-** | **-** | **-** | **(194, 591)** |

The maturity of contingent liabilities and commitments is on demand. This represents the undiscounted cash flows of the Group's contingent liabilities and commitments on the basis of their earliest possible contractual maturity. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

The liquidity risk of the Group is not managed based on the remaining contractual maturities of the financial instruments, as such the Group's expected cash flows on these instruments vary significantly from this analysis (Note: 34). For example, undrawn loan commitments are not expected to be drawn down immediately.

## *40.4 Market risk*

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices. The Group classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored based on a historic VaR methodology that reflects the interdependency between risk variables. The secondary measure for risk management is Basis Point Value (BPV) sensitivity. Non-trading positions are managed and monitored using BPV sensitivity analysis.

**Market risk – Trading**

The Board of Directors has set limits on the level of risk that may be accepted. The Group applies a VaR methodology to assess the market risk positions held and to estimate the potential economic loss based upon assumptions for various changes in market conditions. VaR is a method used to measure financial risk by estimating a potential negative change in the market value of a portfolio at a given confidence level and over a specified time horizon. The Group uses a full linear VaR model for interest rate and foreign exchange rate risk. These calculations are based on historic scenarios derived from a two-year history. The Group has no net position in FX options, nor any position in equity. A nominal technical limit for reminder products, in particular interest rate options; commodity derivatives and structured bonds. Positions in these products are not allowed to be material as back-to-back approach is required.

Standard VaR calculations are supplemented by a sophisticated system of stress tests. They consist of examples of extreme, but plausible events on the financial markets to test their impact on the market value of positions currently held by the Group. The Group analyses scenarios, dependent and independent of the Group’s position. Also, real historical scenarios are evaluated on a regular basis.

To enhance the system of risk management, the Group also uses other methods of risk monitoring, such as interest rate sensitivity BPV, and stop-loss limits.

*Objectives and limitations of the VaR methodology*

The Group uses the historical VaR methodology to measure and monitor interest rate and foreign exchange rate risks in the trading book observing the relevant Basel II standards. The accuracy of estimated results is verified through back-testing.

*VaR assumptions*

When measuring risks, the Group applies VaR assumptions to estimate potential losses at a 99% confidence level that is not expected to be exceeded if the current market risk positions were to be held unchanged for 10 days. The use of a 99% confidence level means that, within a ten-day horizon, losses exceeding the VaR figure should occur, on average, not more than once every 100 days. The Group uses historical daily changes in market variables to assess possible changes in the market value of the trading portfolio based on historical data from the past 500 days.

Since VaR is an integral part of the Group's market risk management, VaR limits have been established for all trading operations and exposures are reviewed daily against the limits by the management.

The VaR model is back tested on a daily basis. Daily VaR (1 day holding period) is compared with theoretic profit or loss from holding previous day position. Daily VaR is also compared with the actual profit or loss made by the trading book.

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

The Group calculate a Stress VaR to fulfil CRR/CRD IV requirements for market risk capital. A one year historic stress period is used for determining of stress scenarios. These in combination with antithetic scenarios for the same periods are used for computation of stress VaR. All other assumptions are identical to the standard VaR measurement.

The tables below show potential gains / (losses) analysed using VaR 10D 99% model in 2017 and 2016:

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2017 | 674 | 4 | 3 | 681 |
| Average during the period | 487 | 5 | (5) | 487 |
| Highest | 793 | 21 | (20) | 794 |
| Lowest | 122 | (2) | 2 | 122 |

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2016 | 148 | 5 | (4) | 149 |
| Average during the period | 168 | 16 | (15) | 169 |
| Highest | 227 | 52 | (53) | 226 |
| Lowest | 119 | 2 | 1 | 122 |

**Market risk – Investment portfolio**

*Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board of Directors has established limits on the BPV sensitivity. The Board of Directors has set secondary limits on interest rate gaps for stipulated periods. Positions are monitored on a weekly basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following tables demonstrate the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's statement of income and equity.

The sensitivity of the statement of income is calculated by revaluing financial assets designated at fair value through profit or loss for the effects of the assumed changes in interest rates. The sensitivity of the statement of income is analysed by the maturity of the asset. The total sensitivity of the statement of income is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The sensitivity of equity is calculated by revaluing Available-for-sale financial assets, including the effect of any associated hedges, and swaps designated as cash-flow hedges, for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by the maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The Group’s investment portfolio consists of predominantly linear interest rate sensitive products.

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) due to revaluation of assets and liabilities that are measured at fair value on recurring basis as at 31 December 2017:

| | | 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 | 11.8 | 5.1 | (27.4) | (43.5) | (54.0) |
| EUR | + 10 | 0.7 | - | (26.3) | (14.8) | (40.4) |
| USD | + 10 | (0.1) | - | (4.4) | (0.1) | (4.6) |
| CZK | - 10 | (11.8) | (5.1) | 27.4 | 43.5 | 54.0 |
| EUR | - 10 | (0.7) | - | 26.3 | 14.8 | 40.4 |
| USD | - 10 | 0.1 | - | 4.4 | 0.1 | 4.6 |

| | | 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 | (19.2) | 0.5 | 121.2 | 16.7 | 119.2 |
| EUR | + 10 | (0.1) | 0.2 | 2.6 | - | 2.7 |
| USD | + 10 | - | (0.1) | (0.9) | - | (1.0) |
| CZK | - 10 | 19.2 | (0.5) | (121.2) | (16.7) | (119.2) |
| EUR | - 10 | 0.1 | (0.2) | (2.6) | - | (2.7) |
| USD | - 10 | - | 0.1 | 0.9 | - | 1.0 |

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 2016:

| | | 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 | 1.9 | (6.1) | (124.1) | (109.7) | (238.0) |
| EUR | + 10 | - | 0.3 | 31.9 | (82.1) | (49.9) |
| USD | + 10 | - | (0.2) | (4.4) | (39.5) | (44.1) |
| CZK | - 10 | (1.9) | 6.1 | 124.1 | 109.7 | 238.0 |
| EUR | - 10 | - | (0.3) | (31.9) | 82.1 | 49.9 |
| USD | - 10 | - | 0.2 | 4.4 | 39.5 | 44.1 |

| | | 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 | (15.3) | 2.6 | 64.2 | 24.4 | 75.9 |
| EUR | + 10 | 0.7 | 0.5 | 1.6 | - | 2.8 |
| USD | + 10 | - | - | (2.1) | - | (2.1) |
| CZK | - 10 | 15.3 | (2.6) | (64.2) | (24.4) | (75.9) |
| EUR | - 10 | (0.7) | (0.5) | (1.6) | - | (2.8) |
| USD | - 10 | - | - | 2.1 | - | 2.1 |

*Currency risk*

Currency risk is the risk that the value of a financial instrument would fluctuate due to changes in foreign exchange rates. The Group adopted a strategy under which the banking book has no open positions in foreign currencies. Positions are monitored on a daily basis and hedging strategies are used to close such positions. Minimum technical residual open positions in foreign currencies are allowed; the Group sets limits for these positions. The technical currency position is added to the currency position of the trading book position and reported in aggregate.

The table below shows the foreign currency risk sensitivity of the statement of income (before tax) as at 31 December 2017 and 2016:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| (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 | 7 | - | - | 7 | - | - |

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 2017) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, is as follows:

| (CZKm) | Change in equity price (%) | Effect on equity |
|---|---|---|
| Visa Inc. quotation | - 10 | (33) |
| | + 10 | 33 |

The effect on equity (as a result of a change in the fair value of equity instruments included in Available-for-sale financial assets at 31 December 2016) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, was as follows:

| (CZKm) | Change in equity price (%) | Effect on equity |
|---|---|---|
| Visa Inc. quotation | - 10 | (29) |
| | + 10 | 29 |

*Prepayment risk*

Prepayment risk is the risk that the Group will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

Prepayment risk is regularly monitored and assessed in the Group. Convenient tools for prepayment risk limitation are applied in the area of mortgage loans particularly.

## 40.5 Operational risk

The Group defines operational risk in line with Basel III as the risk of loss resulting from inadequate or failed internal procedures, people and systems, or from external events. Operational risks include legal, compliance and tax risks. The impact of incidents on the Group's reputation is taken into consideration when assessing the Group's vulnerability in respect of operational risk incidents.

**Principles of Operational Risk Management**

Operational risk management starts with the identification of operational risks having materialized within the Group, as well as an assessment of the Group's vulnerability in respect of potential risks that have not materialised yet. Operational risk management focuses primarily on the key risks and the most risky areas for potential losses. The assessment involves ranking the risks and risk events in terms of their severity and anticipated frequency. The assessment is followed by the decision of an accountable manager, i.e. acceptance of risk or its mitigation by implementing appropriate control measures and/or risk transferring to the 3rd parties and/or risk insurance. Risk events that cannot be prevented may be also mitigated by business continuity arrangements.

**Operational Risk Management Governance**

The basic objective is to make operational risk management a natural part of the decision-making in business units. Operational risk management governance is promoted by the CRO and the Risk Function. The fundamental platform is Business Risk Meeting where ČSOB subsidiaries and selected business units report to CRO about operational risks.

*Non-financial Risk Management Department (NFRD)*

The NFRD is responsible for reporting in the non-financial risk management area, including operational risk management. This includes coordination, implementation of methodology, assurance of independent control, advisory to business units and training. NFRD covers also business continuity and information security areas. Other risks related to operational risk are coordinated by special units, including the Compliance Unit, Legal Unit and Tax Unit.

*Local Operational Risk Managers (the "LORMs")*

LORMs are first line support for business managers in respect of non-financial risks (also responsible for first-line business continuity and information security agendas). Beside frequent contacts, regular meetings of LORMs are organised by the NFRD every quarter for training and exchange of information.

*Crisis Management*

Apart from the regular operational risk management infrastructure, the Group has also established a crisis management infrastructure. Major incidents within the Group are resolved by the Crisis Committee with the involvement of the Board of Director members. Additionally, the Group has in place a procedure for resolving local incidents. This procedure is used for more explicit and structured situations, i.e. not complex crises.

**Building Blocks of Operational Risk Management**

*Loss Data Collection*

Loss events are registered into a loss database, which contains a full description of cases involving a higher level of loss. The quality of loss data is monitored on a daily basis, and data is reconciled regularly.

*Deep Dive*

The Deep Dive (formerly Detailed Risk Scan) aims to identify and quantify operational risks in products, activities, processes and systems. The risks are subsequently either accepted or mitigated via action plans. It consists of workshops organised and facilitated by the LORM, where business representatives and control function representatives discuss operational risks faced in order to reach a consensus on the adequate risk response (risk acceptance or mitigation).

*Process of Change Management*

Besides above mentioned NAPP addressing product changes, Process of Change Management dealing with non-product changes is also used. Each material change must be analysed and identified risks are further managed according to valid rules.

*Risk Scan*

Every year, before the risk appetite statement is defined, the Group executes a risk scan identifying and assessing its top risks. All material risk types are explicitly considered, but it is not necessary that a top risk is ultimately withheld for every risk type. The Risk Scan is executed and reported based on the KBC Group Risk Scan Guidance.

The prime responsibility for the identification and assessment of the top risks lies with the business. Input for the risk scan can be derived from several sources, including the main risks identified in the Internal Control Statement, audit recommendations, existing claims, economic forecasts and so on. The Risk Function facilitates the process. This may include gathering business input and documenting the conclusions of the risk scan. The business may call upon the Risk Function for assistance with the identification and assessment of the top risks as well. In any case, the Risk Function challenges the assessment details.

The results of the risk scan, as well as the risk response thereto (acceptance, non-acceptance, mitigating actions), can lead to changes to the existing business plans. Furthermore, they are used as input for the definition of risk appetite in the strategic planning process.

*Group Key Controls, Zero Tolerances and Local Risk and Control Assessment (GKC ZT)*

The Group Key Controls and Zero Tolerances are top down basic control objectives used to mitigate key & killer non-financial risks (including risks to reputation) that are inherent to the processes of the business entities. Each GKC contain the key & killer operational risks related to the involved business process.

Besides Group Key Controls and Zero Tolerances, local approach called Local Risk and Control Assessment aims to identify new key risks and controls and/or revise GKC risks and controls to have one local view of risk exposure per process.

*Risk assessment and its approval*

All operational risks must be assessed according to Uniform Risk Scale consisting of 4 levels, where financial limits and also non-financial criteria are taken into account. Risk is then approved by respective managerial level based on its impact.

*Action plans*

Action plans are activities set up by 1$^{st}$ LoD that mitigate risk. Action plans are reported by LORMs to NFRD on a Q basis. By using risk based approach, NFRD checks selected action plans when they are proposed for closing by 1$^{st}$ LoD.

*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. Key risk indicators also underpin overall risk profile which is set on the level of subsidiary and selected business units of the Group.

## 41. CAPITAL

**Capital Adequacy**

Capital adequacy measures the financial strength and stability of an institution. It compares the amount of the capital held by a financial institution to the risk of possible decline in value of assets on its statement of financial position.

Capital adequacy (or solvency) risk is the risk that the capital base of the Group might fall below an acceptable level. In practice, this entails checking solvency against the minimum regulatory and in-house solvency ratios and its active steering.

**Capital targets and structure**

Regarding the capital targets and structure, the Group fully follows the KBC Group Capital Policy stating that fully owned subsidiaries shall: (i) hold the regulatory minimum capital (all capital in excess of the regulatory minimum must be held at the Group level), and (ii) build up the regulatory capital from equity.

For the purpose of the ICAAP process, available capital of the Pillar II in the Group coincides with the Common equity Tier 1 capital under Pillar I.

**Managing solvency**

The Group reports its solvency calculated on the basis of IFRS balances, taking into account all relevant regulatory requirements. Solvency targets based on external regulatory capital requirements were met throughout 2017 and 2016 with adequate buffers above the regulatory minimum standards, underpinning the very strong capital position of the Group.

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

In accordance with Basel lll, Pillar 2 requirements, the Group has an Internal Capital Adequacy Assessment Process (ICAAP) in place. The ICAAP examines both the current and future capital situation. To assess the latter situation, a four-year forecast is drawn up for required and available capital, both regulatory and economic, according to a basic scenario that takes account of anticipated internal and external growth, and according to various likely alternative scenarios. The Group uses also other instruments as required by Pillar 2 mainly in the area of capital planning, stress testing and risk strategies.

The Basel lll agreement and corresponding European CRD IV Directive and Regulation introduced new, more stringent capital requirements for financial institutions. According to these requirements, the legal minimum tier-1 ratio increased to 6.0% (with a common equity ratio of 4.5%). On top of this, a capital conservation buffer, and an extra charge for systemic risks of banks were applied. In addition, a countercyclical buffer (0.5% of Common Equity Tier 1, to be determined by the national regulatory authority) was introduced in 2017. The Group incorporated major changes / ratios into the regular management of the risk and capital positions.

The Group manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital instruments.

Within the ICAAP approach the capital economic model (ICM – internal capital model) has been developed in KBC Bank in cooperation with the Group. The model is more risk sensitive and built naturally in way that allows decomposition of the undergone credit risk to various categories (like default risk, migration risk, single-name risk, sector and region concentration and diversifications) . Model was presented to the regulators and approved. The Group plans to roll out the internal model also for the purpose of the pricing and various business analyses to support business decisions.

For the purposes of the capital management in 2016 and 2017, the Bank asked the CNB for a permission to retain a part of the net profit to the official 2016 and 2017 capital adequacy ratio before the audit procedure and annual meeting decision on dividend pay-out. As a consequence of the approval, the ČSOB Tier 1 capital increased by CZK 1,205 m as at 31 December 2017 and CZK 4,992 m as at 31 December 2016.

The following table shows the capital and CAD ratio calculated under Basel III in 2017 and 2016 for the Group.

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Tier 1 capital | 69,098 | 68,981 |
| Tier 2 capital | - | 1,311 |
| **Total capital** | **69,098** | **70,292** |
| Regulatory capital requirements | 32,182 | 30,318 |
| **Risk weighted assets** | **402,278** | **378,970** |
| Capital adequacy ratio | 17.18% | 18.55% |

# SEPARATE FINANCIAL STATEMENTS

## SEPARATE STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| Interest income | 4 | 21,012 | 19,519 |
| Interest expense | 5 | (3,312) | (2,835) |
| **Net interest income** | | **17,700** | **16,684** |
| Fee and commission income | 6 | 8,759 | 8,123 |
| Fee and commission expense | 6 | (3,652) | (3,296) |
| **Net fee and commission income** | | **5,107** | **4,827** |
| Dividend income | 13 | 3,217 | 4,863 |
| Net gains from financial instruments at fair value through profit or loss and foreign exchange | 7 | 4,316 | 3,379 |
| Net realised gains on available-for-sale financial assets | | 455 | 1,295 |
| Other net income | 8 | 1,581 | 837 |
| **Operating income** | | **32,376** | **31,885** |
| Staff expenses | 9 | (6,651) | (6,234) |
| General administrative expenses | 10 | (6,397) | (6,369) |
| Depreciation and amortisation | 20, 21 | (1,139) | (947) |
| **Operating expenses** | | **(14,187)** | **(13,550)** |
| Impairment losses | 11 | (456) | (431) |
| **Profit before tax** | | **17,733** | **17,904** |
| Income tax expense | 12 | (2,377) | (2,360) |
| **Profit for the year** | | **15,356** | **15,544** |

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

# SEPARATE STATEMENT OF OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| **Profit for the year** | | **15,356** | **15,544** |
| Net loss on cash flow hedges | 29 | (1,816) | (831) |
| Net loss on available-for-sale financial assets | 29 | (588) | (1,792) |
| Income tax benefit relating to components of other comprehensive income | 29 | 452 | 498 |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | | **(1,952)** | **(2,125)** |
| **Total comprehensive income for the year, net of tax** | | **13,404** | **13,419** |

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

# SEPARATE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances with central banks and other demand deposits | 14 | 53,191 | 56,721 |
| Financial assets held for trading | 15 | 17,674 | 21,148 |
| Financial assets held for trading pledged as collateral | 15 | 2,097 | 568 |
| Financial assets designated at fair value through profit or loss | 15 | 3,376 | 3,485 |
| Available-for-sale financial assets | 16 | 48,777 | 69,990 |
| Available-for-sale financial assets pledged as collateral | 16 | 5,847 | 3,077 |
| Held-to-maturity investments | 16 | 86,604 | 116,626 |
| Held-to-maturity investments pledged as collateral | 16 | 29,017 | 16,053 |
| Loans and receivables | 17 | 974,013 | 697,939 |
| Fair value adjustments of the hedged items in portfolio hedge | | (3,483) | 797 |
| Investments in subsidiaries, associates and joint ventures | 18 | 49,992 | 46,243 |
| Derivatives used for hedging | 19 | 8,448 | 11,623 |
| Deferred tax assets | 12 | 46 | - |
| Property and equipment | 20 | 5,245 | 3,006 |
| Goodwill and other intangible assets | 21 | 5,295 | 5,249 |
| Non-current assets held-for-sale | 22 | - | 35 |
| Other assets | 23 | 926 | 1,030 |
| **Total assets** | | **1,287,065** | **1,053,590** |
| **LIABILITIES AND EQUITY** | | | |
| Financial liabilities held for trading | 24 | 36,660 | 40,068 |
| Financial liabilities designated at fair value through profit or loss | 24 | 9,498 | 1,620 |
| Financial liabilities at amortised cost | 25 | 1,145,888 | 909,634 |
| Fair value adjustments of the hedged items in portfolio hedge | | (3,803) | 4,796 |
| Derivatives used for hedging | 19 | 10,473 | 10,418 |
| Current tax liabilities | | 266 | 730 |
| Deferred tax liabilities | 12 | - | 308 |
| Other liabilities | 26 | 3,439 | 4,015 |
| Provisions | 27 | 864 | 654 |
| **Total liabilities** | | **1,203,285** | **972,243** |
| Share capital | 28 | 5,855 | 5,855 |
| Share premium | | 20,093 | 20,093 |
| Statutory reserve | | 18,687 | 18,687 |
| Retained earnings | | 37,280 | 32,895 |
| Available-for-sale reserve | 28 | 1,368 | 1,844 |
| Cash flow hedge reserve | 28 | 497 | 1,973 |
| **Total equity** | | **83,780** | **81,347** |
| **Total liabilities and equity** | | **1,287,065** | **1,053,590** |

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

# SEPARATE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2017

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 2016** | **5,855** | **20,093** | **18,687** | **32,132** | **5,942** | **82,709** |
| Profit for the year | - | - | - | 15,544 | - | 15,544 |
| Other comprehensive income for the year | - | - | - | - | (2,125) | (2,125) |
| Total comprehensive income for the year | - | - | - | 15,544 | (2,125) | 13,419 |
| Dividends paid (Note: 13) | - | - | - | (14,781) | - | (14,781) |
| **At 31 December 2016** | **5,855** | **20,093** | **18,687** | **32,895** | **3,817** | **81,347** |
| **At 1 January 2017** | **5,855** | **20,093** | **18,687** | **32,895** | **3,817** | **81,347** |
| Profit for the year | - | - | - | 15,356 | - | 15,356 |
| Other comprehensive income for the year | - | - | - | - | (1,952) | (1,952) |
| Total comprehensive income for the year | - | - | - | 15,356 | (1,952) | 13,404 |
| Merger with subsidiaries Centrum Radlická and Patria Online (Note: 18) | - | - | - | (824) | - | (824) |
| Dividends paid (Note: 13) | - | - | - | (10,147) | - | (10,147) |
| **At 31 December 2017** | **5,855** | **20,093** | **18,687** | **37,280** | **1,865** | **83,780** |

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

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

These separate financial statements were approved for issue by the Board of Directors and signed on its behalf on 19 April 2018 by:

John Arthur Hollows
Chairman of the Board of Directors

Jiří Vévoda
Member of the Board of Directors

# SEPARATE STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2017

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

| (CZKm) | Note | 2017 | 2016 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| Profit before tax | | 17,733 | 17,904 |
| Adjustments for: | | | |
| Interest income | 4 | (21,012) | (19,519) |
| Interest expense | 5 | 3,312 | 2,835 |
| Dividend income | 13 | (3,217) | (4,863) |
| Non-cash items included in profit before tax | 31 | (1,260) | 2,447 |
| Net gains from investing activities | | (129) | (10) |
| **Cash flow from operations before changes in operating assets, liabilities, income tax paid, interest paid and received and dividend received** | | **(4,573)** | **(1,206)** |
| Change in operating assets | 31 | (16,568) | (26,678) |
| Change in operating liabilities | 31 | 100,413 | 65,205 |
| Income tax paid | | (2,675) | (1,692) |
| Interest paid | | (3,312) | (2,835) |
| Interest received | | 22,855 | 21,031 |
| Dividend received | 13 | 3,217 | 4,863 |
| **Net cash flows from operating activities** | | **99,357** | **58,688** |
| **INVESTING ACTIVITIES** | | | |
| Purchase of held-to-maturity investments | | (572) | (4,848) |
| Acquisition and equity increase of subsidiary, associate and joint venture companies | | (7,052) | (647) |
| Reintegration of information and communication services | | - | (955) |
| Maturity / disposal of investment securities | | 15,739 | 7,899 |
| Purchase of property, equipment and intangible assets | | (1,600) | (1,509) |
| Proceeds from sale and equity decrease of subsidiary, associate and joint venture companies | | 276 | 177 |
| Proceeds from disposal of property, equipment, intangible assets and assets held-for-sale | | 89 | 87 |
| **Net cash flows from investing activities** | | **6,880** | **204** |
| **FINANCING ACTIVITIES** | | | |
| Issue of bonds | | - | 500 |
| Dividends paid | 13 | (10,147) | (14,781) |
| **Net cash flows used in financing activities** | | **(10,147)** | **(14,281)** |
| **Net increase / (decrease) in cash and cash equivalents** | | **96,090** | **44,611** |
| Cash and cash equivalents at the beginning of the year | 31 | 88,015 | 43,404 |
| Net increase / (decrease) in cash and cash equivalents | | 96,090 | 44,611 |
| **Cash and cash equivalents at the end of the year** | 31 | **184,105** | **88,015** |

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

# NOTES TO THE SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

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

## 1. CORPORATE INFORMATION

Československá obchodní banka, a. s. (the Bank or ČSOB) is a Czech joint-stock company with its registered office at Radlická 333/150, Prague 5, Czech Republic. The Corporate ID is 00001350. The parent company of the Bank is KBC Bank NV (KBC Bank), which is controlled by the KBC Group NV (KBC Group).

The Bank is operating in the Czech Republic. It is a universal bank offering to its clients a wide range of banking products and services, including the products and services of the entire ČSOB Group. The main activities services of the ČSOB include: accepting deposits from the public, providing loans, investing in securities on the Bank´s own account, payments and clearance, the issuance and administration of payment instruments, the provision of guarantees, the issuance of letters of credit, the provision of collection services, the provision of all investment service according to a special law, the issuance of mortgage bonds, financial brokerage, the provision of depository services, exchange office services (purchase of foreign exchange), the provision of banking information, trading in foreign exchange values and gold on the Bank´s own account or on a client´s account, the rental of safe-deposit boxes. Furthermore, the Bank performs activities directly related to the activities described above and activities carried out for other parties if they relate to the running of the Bank and operation of other banks, financial institutions and enterprises providing ancillary banking services, controlled by the Bank.

## 2. ACCOUNTING POLICIES

### *2.1 Basis of preparation*

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

The separate financial statements have been prepared under the historical cost convention, except for available-for-sale investments, financial assets and financial liabilities at fair value through profit or loss and all derivative contracts that have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortised cost, are adjusted to record changes in fair value attributable to the risks that are being hedged. Assets held for sale are measured at fair value less cost to sell if this value is lower than their carrying amount (i.e. cost less accumulated depreciation and impairment losses). The separate financial statements are presented in millions of Czech Crowns (CZKm) which is the Bank's presentation currency. The preparation of separate financial statements is required by the Act on Accounting. Simultaneously, the Bank also prepares consolidated financial statements of the ČSOB Group in accordance with the International Financial Reporting Standards as adopted by the European Union (EU IFRS).

**Statement of compliance**

The separate financial statements of ČSOB have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

### *2.2 Significant accounting judgements and estimates*

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

**Fair value of financial instruments (Note: 30)**

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

**Impairment losses on financial instruments (Note: 38.2)**

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

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

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

**Goodwill impairment (Note: 21)**

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

**Impairment of investment in subsidiaries (Note: 18)**

Investments in subsidiaries are reviewed for impairment indicators at least annually. In cases where impairment indicators are identified, investment is tested for impairment by comparing the recoverable amount with the investment carrying amount. Determining and assessing of the impairment indicators as well as determining the recoverable amount requires judgment.

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

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

## *2.3 Changes in accounting policies*

**Effective from 1 January 2017**

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

**Disclosure Initiative (Amendment to IAS 7)** is effective for periods on or after 1 January 2017. The amendment requires that the following changes in liabilities arising from financing activities are disclosed: (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes.

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

**Effective after 1 January 2017**

The following standards, amendments and interpretations have been issued and are effective after 1 January 2017. The Bank has decided not to early adopt them. Unless otherwise described below, the new standards, amendments and interpretations are not expected to significantly affect the Bank financial statements.

**IFRS 9 Financial Instruments (2014)** is effective for periods beginning on or after 1 January 2018. The implementation is structured along two pillars: namely classification & measurement and impairment, as well as a common work stream relating to the impact on reporting and disclosures.

**Classification and measurement of financial instruments**

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

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

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

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

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

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

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

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

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

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

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

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

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

**Impairment of financial assets**

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

Stage 1 (or Performing) includes financial instruments with credit risk that has not increased significantly since initial recognition. 12-month expected credit losses are recognised for these assets. Interest income is based on the gross carrying amount of the assets.

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

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

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

The Bank has established policies and processes to assess whether credit risk has increased significantly at the end of each reporting period and, therefore, “staging” is required (i.e. moving from one stage to another). For the loan portfolio, a multi-tier approach has been adopted to staging, based on internal credit ratings, forbearance measures, collective assessment and days past due as a backstop. A similar multi-tier approach will be used for the investment portfolio except that the Bank intends to use the low-credit-risk exemption, meaning that all bonds in scope with a PD of 1 to 3 are considered to be in Stage 1, unless any of the other triggers indicate otherwise.

For Stage 1 and Stage 2 - under IAS 39 - the Bank records incurred-but-not-reported (IBNR) impairment losses, which are influenced by emergence periods. Under IFRS 9, impairment of financial assets is calculated on a 12-month expected credit loss (ECL) basis for Stage 1 and on a lifetime ECL basis for Stage 2. As a consequence, impairment levels are generally expected to increase.

Forward looking information is incorporated into the staging criteria and measurement of ECL. Different macroeconomic factors are taken into consideration and the Bank applies three scenarios to evaluate a range of possible outcomes. The impact of first time application has been positively influenced by the current benign macroeconomic environment. Impairment levels under current prudential requirements will differ from IFRS 9 because of (i) application of a through-the-cycle estimate for prudential purposes as opposed to a point-in-time estimate under IFRS 9, (ii) application of a 12-month PD for prudential purposes as opposed to a lifetime PD under IFRS 9 (for 'Stage 2' and 'Stage 3'), (iii) inclusion of prudential floors and downturn adjustments in the PD, EAD and LGD estimates for prudential purposes and iv) inclusion of macroeconomic parameters under IFRS 9.

The first time application of IFRS9 led to an increase of CSOB Total capital ratio by 6 basis points. A combined negative effect of reclassification of part of the Treasury bond portfolio and initial ECL creation was outweighed by reduction of IRB shortfall.

**Hedge accounting**

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

**Prepayment Features with Negative Compensation (Amendments to IFRS 9)** is effective for periods beginning on or after 1 January 2019. The amendment clarifies that financial assets with contractual cash flows that are solely payments of principal and interest and prepayment features that may result in reasonable negative compensation for the early termination of the contract are eligible to be measured at amortised cost or at fair value through other comprehensive income.

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

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

1. Identify the contract with the customer (a contract exists only when it is 'probable' that the entity will collect the consideration)

2. Identify separate Performance Obligations in the contract (a promise to transfer good or service)

3. Determine the transaction price (only an amount not subject to subsequent future reversals)

4. Allocate the transaction price to each Performance Obligation

5. Recognise revenue when or as each Performance Obligation is satisfied

As the standard is not applicable to insurance contracts, financial instruments or lease contracts, the impact on the Bank will be limited.

**IFRS 16 Leases** is effective for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor'). The new standard requires lessees to recognize most leases in their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions. Lessor accounting is substantially unchanged. The Bank is currently assessing the impact that IFRS 16 will have on the financial statements.

**IFRS 17 Insurance Contracts** is effective for annual periods beginning on or after 1 January 2021 and has not yet been endorsed by the EU. The standard establishes principles for the recognition, measurement, presentation and disclosure of issued insurance and held reinsurance contracts, life and non-life. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued.

**Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)** is effective for annual periods beginning on or after 1 January 2018. The amendment permits insurers that meet specified criteria to apply a temporary exemption from IFRS 9. Further it permits insurers to apply the overlay approach to designated financial assets and to reclassify in specified circumstances some or all of their financial assets so that the assets are measured at fair value through profit or loss.

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

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

**Long-term Interests in Associates and Joint Ventures (Amendments to IAS 28)** is effective for periods on or after 1 January 2019. The amendment clarifies that any long-term interests in an associate or joint venture that, in substance, form a part of the entity´s net investment are in scope of IFRS 9.

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

**IFRIC 23 Uncertainty over Income Tax Treatments** is effective for periods on or after 1 January 2019. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatment.

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

**Annual Improvements to IFRS Standards (2015 - 2017 Cycle)**, issued in December 2017 with a view to remove inconsistencies and clarify wording. There are separate transitional provisions for each standard, all of which are applicable on or after 1 January 2019.

## *2.4 Summary of significant accounting policies*

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

**(1) Foreign currency translation**

Items included in the financial statements of the Bank are initially measured using the currency of the primary economic environment in which the Bank operates ("the functional currency").

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

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

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

**(2) Investments in subsidiaries, associates and jointly controlled entities**

A subsidiary is an entity which is controlled by the Bank (parent entity). The Bank controls an investee when the Bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

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

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

Investments in subsidiaries, associates and joint ventures are carried at cost less any provision for impairment. Dividends received from investments in subsidiaries, associates and joint ventures are recorded in Dividend income.

**(3) Financial instruments - recognition and derecognition**

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

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

**(4) Financial instruments - initial recognition and subsequent measurement**

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

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

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

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

- *Derivatives held for trading*

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

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

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

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

- *Financial instruments held for trading other than derivatives*

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

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

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

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

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

*(ii) Held-to-maturity investments*

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

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

*(iii) Loans and receivables*

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

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

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

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

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

*(v) Financial liabilities at amortised cost*

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

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

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

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

**(5) Repurchase and reverse repurchase agreements**

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

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

**(6) Determination of fair value**

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

**(7) Impairment of financial assets**

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

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

*(i) Assets carried at amortised cost*

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

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

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

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

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

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

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

*(ii) Renegotiated loans*

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

*(iii) Financial assets carried at fair value*

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

**(8) Impairment of non-financial assets**

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

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

**(9) Hedge accounting**

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

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

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

*(i) Cash flow hedges*

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

*(ii) Fair value hedges*

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

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

**(10) Offsetting financial instruments**

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

**(11) Reclassification of financial assets**

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

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

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

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

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

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

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

**(12) Leasing**

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

*(i) Bank as a lessee*

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

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

*(ii) Bank as a lessor*

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

**(13) Recognition of income and expenses**

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

*(i) Interest income and expense*

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

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

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

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

*(ii) Fee and commission income*

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

*(iii) Dividend income*

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

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

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

**(14) Cash and cash equivalents**

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

**(15) Property and equipment**

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

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

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

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

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

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

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

### (16) Business combinations and Goodwill

Business combinations are generally reflected in separate financial statements only if the Bank acquires business that doesn't represent separate legal entity.

The acquisition method of accounting is used to account for the acquisition of businesses by the Bank that are not under common control as the Bank was. The cost of an acquisition is measured as the total of the fair values of assets transferred, equity instruments issued and liabilities incurred or assumed at the date of exchange. Non-controlling interests in the acquirees are measured at the proportionate share of the acquiree's recognised net identifiable assets. Any acquisition-related costs are recognised in the statement of income when they are incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

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

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

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

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

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

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

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

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

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

### (17) Intangible assets

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

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

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

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

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

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

**(18) Financial guarantees**

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

**(19) Employee retirement benefits**

*Retirement benefits*

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

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

*Termination benefits*

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

**(20) Provisions**

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

**(21) Income tax**

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

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

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

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

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

- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss,

- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will be reversed in the foreseeable future and the taxable profit will be available against which the temporary differences can be utilised.

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

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

The Bank records a net deferred tax asset under Deferred tax assets and a net deferred tax liability under Deferred tax liabilities.

**(22) Share capital and reserves**

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

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

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

**(23) Fiduciary activities**

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

**(24) Operating segments**

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

## *2.5 Comparative balances*

**Reclassification**

In 2017, the ČSOB and the KBC Group have decided to change presentation of some items within the structure of the financial statements consistently with the rules of the Unified Framework of the Consolidated Financial Reporting (FINREP). As a result, demand deposits in other credit institutions measured at amortised cost have been reclassified from the Loans and receivables to the Cash and balances with central banks and other demand deposits. Such a reclassification did not impact the statement of cash flows since these demand deposits were already included in the balance of cash equivalents before the reclassification.

Furthermore, ČSOB decided to change presentation of debt securities pledged as collateral in repo transactions or securities lending in 2017. The Bank shifted these pledged assets from the original captions to the separate lines in the statement of financial position, so that the pledged assets are not mixed together with other financial assets on the position of the Bank.

In 2017, the Bank changed the presentation of interest received, interest paid and dividends received in the separate statement of cash flows. These items, previously reported within a separate table below the statement, have been incorporated into the statement of cash flows as part of the net cash flows from operating activities.

Such a presentation provides more reliable and more relevant information about the nature of the assets and cash flows including an increase of comparability among different reporters on the market. To conform to the change in presentation in the current year, certain items in the comparative balances have been reclassified.

A reconciliation of the selected items of the separate statement of financial position as at 31 December 2016 is provided below:

| (CZKm) | 2016 As reported | Reclassification of demand deposits | Reclassification of pledged assets | 2016 Reclassified |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash, balances with central banks and other demand deposits | 55,920 | 801 | | 56,721 |
| Financial assets held for trading | 21,716 | | (568) | 21,148 |
| Financial assets held for trading pledged as collateral | - | | 568 | 568 |
| Available-for-sale financial assets | 73,067 | | (3,077) | 69,990 |
| Available-for-sale financial assets pledged as collateral | - | | 3,077 | 3,077 |
| Held-to-maturity investments | 132,679 | | (16,053) | 116,626 |
| Held-to-maturity investments pledged as collateral | - | | 16,053 | 16,053 |
| Loans and receivables | 698,740 | (801) | | 697,939 |

A reconciliation of the selected items of the separate statement of financial position as at 1 January 2016 is provided below:

| (CZKm) | 31 December 2015 As reported | Reclassification of demand deposits | Reclassification of pledged assets | 1 January 2016 Reclassified |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash, balances with central banks and other demand deposits | 116,592 | 712 | | 117,304 |
| Available-for-sale financial assets | 74,389 | | (1,056) | 73,333 |
| Available-for-sale financial assets pledged as collateral | - | | 1,056 | 1,056 |
| Held-to-maturity investments | 136,432 | | (2,433) | 133,999 |
| Held-to-maturity investments pledged as collateral | - | | 2,433 | 2,433 |
| Loans and receivables | 504,168 | (712) | | 503,456 |

## 3. SEGMENT INFORMATION

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

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

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

**Definitions of customer operating segments:**

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

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

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

**Group Centre:** The Group Centre segment consists of positions and results of Asset Liability Management (ALM), the results of the reinvestment of free equity of the Bank, dividends from subsidiaries, associates and joint ventures and items not directly attributable to other segments.

In 2017, a part of the other operating expenses (Facility management, IT), previously allocated into segments, started to be reported at Group Centre. Comparative figures in the Statement of income for 2016 have been reclassified.

**Segment reporting information by customer segments for 2017**

| (CZKm) | Retail | Relationship services | Financial markets | Group Centre | Total |
|---|---|---|---|---|---|
| ***Statement of income*** | | | | | |
| Net interest income | 7,089 | 7,726 | 329 | 2,556 | 17,700 |
| Net fee and commission income | 2,067 | 2,582 | 358 | 100 | 5,107 |
| Dividend income | - | - | - | 3,217 | 3,217 |
| Net gains / (losses) from financial instruments at fair value through profit or loss | 606 | 1,891 | 2,553 | (734) | 4,316 |
| Net realised gains on available-for-sale financial assets | - | - | - | 455 | 455 |
| Other net income | 44 | 1 | 4 | 1,532 | 1,581 |
| **Operating income** | **9,806** | **12,200** | **3,244** | **7,126** | **32,376** |
| *of which:* | | | | | |
| *External operating income* | *4,664* | *9,885* | *3,244* | *14,583* | *32,376* |
| *Intersegment operating income* | *5,142* | *2,315* | *-* | *(7,457)* | *-* |
| Depreciation and amortisation | (25) | (2) | - | (1,112) | (1,139) |
| Other operating expenses | (6,604) | (3,603) | (249) | (2,592) | (13,048) |
| **Operating expenses** | **(6,629)** | **(3,605)** | **(249)** | **(3,704)** | **(14,187)** |
| Impairment losses - additions | (524) | (1,912) | - | (194) | (2,630) |
| Impairment losses - reversals | 659 | 1,510 | - | 5 | 2,174 |
| **Profit before tax** | **3,312** | **8,193** | **2,995** | **3,233** | **17,733** |
| Income tax expense | (629) | (1,557) | (569) | 378 | (2,377) |
| **Segment profit** | **2,683** | **6,636** | **2,426** | **3,611** | **15,356** |
| ***Assets and liabilities*** | | | | | |
| Segment assets | 27,665 | 237,072 | 46,617 | 975,711 | 1,287,065 |
| Non-current assets held-for-sale | - | - | - | - | - |
| **Total assets** | 27,665 | 237,072 | 46,617 | 975,711 | **1,287,065** |
| **Total liabilities** | **388,544** | **388,431** | **47,210** | **379,100** | **1,203,285** |
| **Capital expenditure** | **317** | **4** | **-** | **1,279** | **1,600** |

## Segment reporting information by customer segments for 2016

| (CZKm) | Retail | Relationship services | Financial markets | Group Centre | Total |
|---|---|---|---|---|---|
| ***Statement of income*** | | | | | |
| Net interest income | 7,338 | 7,361 | (36) | 2,021 | 16,684 |
| Net fee and commission income | 2,229 | 2,306 | 318 | (26) | 4,827 |
| Dividend income | - | - | - | 4,863 | 4,863 |
| Net gains from financial instruments at fair value through profit or loss | 511 | 1,533 | 912 | 423 | 3,379 |
| Net realised gains on available-for-sale financial assets | - | - | - | 1,295 | 1,295 |
| Other net income | 36 | 3 | - | 798 | 837 |
| **Operating income** | **10,114** | **11,203** | **1,194** | **9,374** | **31,885** |
| *of which:* | | | | | |
| *External operating income* | *4,510* | *9,169* | *1,194* | *17,012* | *31,885* |
| *Intersegment operating income* | *5,604* | *2,034* | *-* | *(7,638)* | *-* |
| Depreciation and amortisation | (37) | (1) | - | (909) | (947) |
| Other operating expenses | (6,415) | (3,489) | (228) | (2,471) | (12,603) |
| **Operating expenses** | **(6,452)** | **(3,490)** | **(228)** | **(3,380)** | **(13,550)** |
| Impairment losses - additions | (364) | (1,740) | - | (305) | (2,409) |
| Impairment losses - reversals | 451 | 1,136 | - | 391 | 1,978 |
| **Profit before tax** | **3,749** | **7,109** | **966** | **6,080** | **17,904** |
| Income tax expense | (712) | (1,350) | (183) | (115) | (2,360) |
| **Segment profit** | **3,037** | **5,759** | **783** | **5,965** | **15,544** |
| ***Assets and liabilities*** | | | | | |
| Segment assets | 23,737 | 231,728 | 21,231 | 776,859 | 1,053,555 |
| Non-current assets held-for-sale | - | - | - | 35 | 35 |
| **Total assets** | **23,737** | **231,728** | **21,231** | **776,894** | **1,053,590** |
| **Total liabilities** | **365,420** | **312,778** | **40,981** | **253,064** | **972,243** |
| **Capital expenditure** | **254** | **15** | **-** | **1,239** | **1,508** |

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) | 2017 | 2016 |
|---|---|---|
| Cash balances with central banks and other demand deposits | 88 | 53 |
| Loans and receivables | | |
| Credit institutions | 3,790 | 2,390 |
| Other than credit institutions | 7,629 | 7,594 |
| Available-for-sale financial assets incl. assets pledged as collateral | 1,489 | 1,610 |
| Held-to-maturity investments incl. assets pledged as collateral | 4,428 | 5,091 |
| Financial assets held for trading incl. assets pledged as collateral (Note: 7) | 229 | 345 |
| Financial assets designated at fair value through profit or loss (Note: 7) | 58 | 60 |
| Derivatives used as economic hedges (Note: 7) | 195 | 148 |
| Derivatives used for hedging (Note: 7) | 1,905 | 1,854 |
| Negative interest from financial liabilities measured at amortised cost | 1,186 | 349 |
| Negative interest from financial liabilities measured at fair value (Note: 7) | 15 | 25 |
| | **21,012** | **19,519** |

## 5. INTEREST EXPENSE

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Financial liabilities at amortised cost | | |
| Central banks | 3 | - |
| Credit institutions | 818 | 483 |
| Other than credit institutions | 900 | 835 |
| Debt instruments in issue | 115 | 66 |
| Discount amortisation on other provisions (Note: 27) | 3 | 3 |
| Financial liabilities held for trading (Note: 7) | 445 | 414 |
| Financial liabilities designated at fair value through profit or loss (Note: 7) | 43 | - |
| Derivatives used as economic hedges (Note: 7) | 139 | 77 |
| Derivatives used for hedging (Note: 7) | 839 | 953 |
| Negative interest from financial assets measured at fair value (Note: 7) | 7 | 4 |
| | **3,312** | **2,835** |

## 6. NET FEE AND COMMISSION INCOME

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Fee and commission income** | | |
| Payment services | 5,459 | 5,290 |
| Administration of credits | 1,218 | 1,144 |
| Collective investments | 823 | 664 |
| Custody | 202 | 185 |
| Securities | 176 | 204 |
| Asset management | 45 | 79 |
| Other | 836 | 557 |
| | **8,759** | **8,123** |
| **Fee and commission expense** | | |
| Payment services | 2,072 | 1,481 |
| Retail service fees | 963 | 1,017 |
| Commissions to agents | 83 | 54 |
| Other | 534 | 744 |
| | **3,652** | **3,296** |
| **Net fee and commission income** | **5,107** | **4,827** |

## 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) | 2017 | 2016 |
|---|---|---|
| **Net gains from financial instruments at fair value through profit or loss and foreign exchange - as reported** | **4,316** | **3,379** |
| Net interest income (Notes: 4, 5) | 928 | 984 |
| | **5,244** | **4,363** |
| **Financial instruments held for trading and derivatives used for hedging** | | |
| Interest rate contracts | (126) | 1,618 |
| Foreign exchange | 11,676 | 871 |
| Equity contracts | 349 | 168 |
| Commodity contracts | 10 | 15 |
| | 11,909 | 2,672 |
| **Financial instruments designated at fair value through profit or loss** | | |
| Financial assets designated at fair value through profit or loss | (31) | 78 |
| Financial liabilities designated at fair value through profit or loss | 22 | (73) |
| Foreign exchange differences | (6,656) | 1,686 |
| **Financial instruments at fair value through profit or loss and foreign exchange** | **5,244** | **4,363** |

## 8. OTHER NET INCOME

| (CZKm) | 2017 | 2016 |
|---|---|---|
| ICT services | 661 | 642 |
| Net gain on disposal of Held-to-maturity investments | 126 | 2 |
| Net operating leasing and rental income | 81 | 81 |
| Services provided to Československá obchodná banka, a.s. (ČSOB SK) (excluding income from ICT services) | 51 | 71 |
| Net gain on disposal of loans and receivables | 4 | 1 |
| Net gain on disposal of non-current assets held-for-sale | 3 | 8 |
| Net increase in provisions for legal issues and other losses | (3) | (78) |
| Other | 658 | 110 |
| | **1,581** | **837** |

## 9. STAFF EXPENSES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Wages and salaries | 4,745 | 4,385 |
| Salaries and other short-term benefits of top management | 91 | 90 |
| Social security charges | 1,591 | 1,500 |
| *of which pension security charges (obligatory)* | *971* | *910* |
| Pension (voluntary) and similar expenses | 132 | 127 |
| Other | 92 | 132 |
| | **6,651** | **6,234** |

### Number of Bank personnel

The number (in full-time equivalents) of Bank personnel was 7,150 at 31 December 2017 (31 December 2016: 7,071).

### Management bonus scheme

Included within Salaries and other short-term benefits of top management are base salaries, annual bonuses and other short-term benefits 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.

A bonus scheme of the Bank follows the changes in legislation in previous years. Half of the bonus is provided in a non-cash instrument, so called "Virtual investment certificate" (VIC). VIC is linked to the Economic Value Added of Group which captures both finance and risk aspects. Another half of the bonus is paid in cash. The payment of half of the bonus (both cash and non-cash portion) is deferred for up to the next five years following the initial assignment of the benefit.

### Retirement benefits

The Bank provides its employees (including top management) with a voluntary defined contribution retirement scheme. Participating employees can contribute 1% or 2% of their salaries to pension companies approved by the Ministry of Finance of the Czech Republic (MF CZ), with an additional contribution of the Bank of 2% or 3% of their salaries, respectively.

### Termination benefits

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

In the case of contract terminations, the members of the Board of Directors are entitled to receive an amount of 0 to 12 monthly salaries as termination benefits (according to conditions of individual contracts). In 2017 and 2016, no such compensation was paid.

## 10. GENERAL ADMINISTRATIVE EXPENSES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Information technologies | 2,321 | 2,172 |
| Marketing | 588 | 528 |
| Rental expenses on land and buildings – minimum lease payments | 504 | 702 |
| Other building expenses | 451 | 428 |
| Professional fees | 444 | 449 |
| Contribution to the Single Resolution Mechanism | 440 | 435 |
| Communication | 342 | 336 |
| Retail service fees | 232 | 200 |
| Payment cards and electronic banking | 211 | 152 |
| Travel and transportation | 181 | 146 |
| Deposit insurance premium and contribution to the Securities Traders Guarantee Fund | 177 | 158 |
| Administration | 168 | 188 |
| Training | 72 | 64 |
| Car expenses | 43 | 40 |
| Insurance | 41 | 36 |
| Other | 182 | 335 |
| | **6,397** | **6,369** |

## 11. IMPAIRMENT LOSSES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Impairment of loans and receivables (Notes: 17, 31, 38.2) | (18) | (551) |
| Provisions for loan commitments and guarantees (Notes: 27, 31) | (237) | 53 |
| Impairment of available-for-sale financial assets(Note: 16, 31) | (1) | - |
| Net impairment of investments in subsidiaries, associates and joint ventures (Notes: 18, 31) | (3) | 151 |
| Impairment of property and equipment (Notes: 20, 31) | (6) | (9) |
| Impairment of held-to-maturity investments (Notes: 22, 31) | (2) | - |
| Impairment of other assets (Note: 31) | 1 | (1) |
| Impairment of intangible assets (Notes: 20, 31) | (190) | (74) |
| | **(456)** | **(431)** |

## 12. INCOME TAX

The components of income tax expense for the years ended 31 December 2017 and 2016 are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Current tax expense | 2,225 | 2,287 |
| Net provisions for tax disputes | 7 | 149 |
| Previous year over accrual of current tax | (24) | (13) |
| Deferred tax expense / (benefit) relating to the origination and reversal of temporary differences | 169 | (63) |
| | **2,377** | **2,360** |

A reconciliation between the tax expense and the accounting profit multiplied by the domestic tax rate for the years ended 31 December 2017 and 2016 is as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Profit before taxation | 17,733 | 17,904 |
| Applicable tax rates | 19% | 19% |
| Taxation at applicable tax rates | 3,369 | 3,402 |
| Net provisions for tax disputes | 7 | 149 |
| Previous year over accrual of current tax | (24) | (13) |
| Tax effect of non-taxable income | (1,227) | (1,572) |
| Tax effect of non-deductible expenses | 252 | 394 |
| | **2,377** | **2,360** |

The applicable tax rate for 2017 was 19% (2016: 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) | 2017 | 2016 |
|---|---|---|
| **At 1 January** | **(308)** | **(870)** |
| Statement of income | (169) | 63 |
| Available-for-sale securities (Note: 29) | | |
| Fair value remeasurement | 2 | 61 |
| Transfer to net profit | 110 | 280 |
| Cash-flow hedges (Note: 29) | | |
| Fair value remeasurement | 185 | (21) |
| Transfer to net profit (Note: 19) | 155 | 179 |
| Other – acquisition of business under common control (Note: 18) | 71 | - |
| **At 31 December** | **46** | **(308)** |

Deferred tax assets / (liability) are attributable to the following items:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Deferred tax assets / (liability)** | | |
| Employee benefits | 257 | 265 |
| Temporary difference resulting from tax depreciation | 220 | 180 |
| Provisions | 133 | 97 |
| Legal claim | 124 | 202 |
| Temporary difference resulting from tax depreciation related to acquisition of ICT function | 124 | 134 |
| Temporary difference resulting from tax depreciation related to merger with Centrum Radlická (Note: 18) | 71 | - |
| Loans and receivables - bonds reclassified from Available-for-sale securities (Note: 16) | 69 | 73 |
| Impairment losses on tangible and intangible assets | 40 | 17 |
| Impairment losses on financial investments | 26 | 26 |
| Allowances for credit losses | - | 132 |
| Held-to-maturity investments - bonds reclassified from Available-for-sale securities (Note: 16) | (45) | (72) |
| Cash-flow hedges | (123) | (463) |
| Available-for-sale securities | (344) | (433) |
| Amortisation of goodwill | (511) | (478) |
| Other temporary differences | 5 | 12 |
| | **46** | **(308)** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Temporary difference resulting from tax depreciation | 40 | (51) |
| Provisions | 36 | (2) |
| Impairment losses on tangible and intangible assets | 23 | 15 |
| Employee benefits | (8) | (15) |
| Temporary difference resulting from tax depreciation related to acquisition of ICT function | (10) | (10) |
| Amortisation of goodwill | (33) | (36) |
| Legal claim | (78) | 109 |
| Allowances for credit losses | (132) | 39 |
| Other temporary differences | (7) | 14 |
| | **(169)** | **63** |

The Bank’s management believes it is probable that the Bank will fully realise its gross deferred income tax assets based upon the Bank’s current and expected future level of taxable profits and the expected offset from gross deferred income tax liabilities.

## 13. DIVIDENDS PAID AND RECEIVED

### Dividends paid

Dividends paid are not accounted for until they have been ratified by a resolution of the sole shareholder on a profit distribution. The decision of a profit allocation for 2017 has not been taken before the date of issue of the financial statements.

Based on a sole shareholder decision from 27 April 2017, a dividend of CZK 34.66 per share was paid for 2016, representing a total dividend of CZK 10,147 m.

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

### Dividends received

The following table shows a dividend received by the companies for 2017 and 2016:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Hypoteční banka, a.s. | 1,800 | 2,990 |
| Českomoravská stavební spořitelna, a.s. | 647 | 607 |
| ČSOB Leasing, a.s. | 421 | 677 |
| ČSOB Penzijní společnost, a. s., a member of the ČSOB group | 142 | 72 |
| ČSOB Factoring, a.s. | 81 | 100 |
| Bankovní informační technologie, s.r.o. | 46 | 45 |
| Patria Finance, a.s. | 38 | - |
| Patria Online, a.s. | 27 | 321 |
| První certifikační autorita, a.s. | 5 | 4 |
| ČSOB Advisory, a.s. | 4 | 2 |
| CBCB - Czech Banking Credit Bureau, a.s. | 2 | 2 |
| ČSOB Pojišťovna, a. s., a member of the ČSOB holding | 2 | 2 |
| Visa Inc. | 2 | - |
| ČSOB Asset Management, a.s., investment company | - | 41 |
| | **3,217** | **4,863** |

## 14. CASH AND BALANCES WITH CENTRAL BANKS AND OTHER DEMAND DEPOSITS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Cash (Note: 31) | 9,742 | 9,074 |
| Mandatory minimum reserves (Note: 31, 32, 38.2) | 12,823 | 10,774 |
| Other balances with central banks (Notes: 31, 32, 38.2) | 29,718 | 36,072 |
| Other demand deposits in credit institutions (Notes: 31, 32, 38.2) | 908 | 801 |
| | **53,191** | **56,721** |

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

Other balances with central banks contain overnight loans provided to central bank in the amount of CZK 27,250 m at 31 December 2017 (31 December 2016: CZK 33,900 m).

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Financial assets held for trading** | | |
| Loans and advances | | |
| Money market placements | - | 15 |
| Debt instruments | | |
| General government | 1,047 | 3,959 |
| Credit institutions | 2,691 | 3,909 |
| Corporate | 430 | 247 |
| Derivative contracts (Note: 19) | | |
| Trading derivatives | 12,224 | 12,179 |
| Derivatives used as economic hedges | 1,282 | 839 |
| | **17,674** | **21,148** |
| **Financial assets held for trading pledged as collateral** | | |
| Debt instruments | | |
| General government | 2,097 | 568 |
| | **2,097** | **568** |
| **Financial assets designated at fair value through profit or loss** | | |
| Debt instruments | | |
| Credit institutions | 3,376 | 3,485 |
| | **3,376** | **3,485** |
| **Financial assets at fair value through profit or loss** | **23,147** | **25,201** |

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

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

## 16. FINANCIAL INVESTMENTS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Available-for-sale financial assets** | | |
| Debt securities | | |
| General government | 27,356 | 38,577 |
| Credit institutions | 20,549 | 30,645 |
| Corporate | 418 | 426 |
| Equity securities | | |
| Corporate | 454 | 342 |
| | **48,777** | **69,990** |
| **Available-for-sale financial assets pledged as collateral** | | |
| Debt securities | | |
| General government | 3,893 | 1,009 |
| Credit institutions | 1,954 | 2,068 |
| | **5,847** | **3,077** |
| **Held-to-maturity investments** | | |
| Debt securities | | |
| General government | 84,453 | 114,399 |
| Credit institutions | 1,317 | 1,394 |
| Corporate | 834 | 833 |
| | **86,604** | **116,626** |
| **Held-to-maturity investments pledged as collateral** | | |
| Debt securities | | |
| General government | **29,017** | **16,053** |
| | **29,017** | **16,053** |
| **Financial investments** | **170,245** | **205,746** |

Included within Financial investments pledged as collateral are debt securities pledged as collateral in repo transactions in the amount of CZK 21,303 m (2016: CZK 9,578 m) or securities lending in the amount of CZK 13,561 m (2016: CZK 9,552 m). Under the terms and conditions of the pledge in repo transactions or securities lending, the transferee has a right to sell or repledge the collateral. Included within Financial investments are debt securities of CZK 15,514 m (2016: CZK 12,601 m) pledged as collateral of term deposits and financial guarantees.

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

In July and August 2013, a part of the portfolio of mortgage bonds was transferred from the Available-for-sale financial assets to the portfolio of Loans and receivables in the fair value of CZK 62,978 m, as a result of a change of the Bank's intention to hold the bonds to maturity. Unrealised losses from the bonds in the amount of CZK 463 m at the date of the transfer remained a part of the Available-for-sale reserve and will be amortised to the interest income over the remaining maturity of the bonds (2012: CZK 4,943 m).

Set out below is a comparison of the carrying amounts and fair values of the Bank's financial instruments that were reclassified from the Available-for-sale financial assets:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| (CZKm) | Carrying value | Fair value | Carrying value | Fair value |
| **Financial assets** | | | | |
| Held-to-maturity investments | 6,268 | 6,758 | 8,552 | 9,396 |
| Loans and receivables | 61,232 | 57,496 | 61,586 | 58,220 |

The following table shows the total fair value gain or loss in Statement of other comprehensive income that would have been recognised during 2017 if the Bank had not reclassified financial assets from Available-for-sale. This disclosure is provided for information purposes only; it does not reflect what has been recorded in the financial statements:

| (CZKm) | Debt sovereign bonds | Mortgage bonds | Total |
|---|---|---|---|
| Net gain / (loss) on Available-for-sale assets (before tax) | (354) | (370) | (724) |

The following table shows the total fair value gain or loss in Statement of other comprehensive income that would have been recognised during 2016 if the Bank had not reclassified financial assets from Available-for-sale. This disclosure is provided for information purposes only; it does not reflect what has been recorded in the financial statements:

| (CZKm) | Debt sovereign bonds | Mortgage bonds | Total |
|---|---|---|---|
| Net gain / (loss) on Available-for-sale assets (before tax) | (155) | 606 | 451 |

The following table shows the net profit or loss recorded on reclassified assets in 2017:

| (CZKm) | Debt sovereign bonds | Mortgage bonds | Total |
|---|---|---|---|
| Interest income (before tax) | 250 | 548 | 798 |

The following table shows the net profit or loss recorded on reclassified assets in 2016:

| (CZKm) | Debt sovereign bonds | Mortgage bonds | Total |
|---|---|---|---|
| Interest income (before tax) | 405 | 605 | 1,010 |

The following table shows the expected undiscounted cash recoveries, as assessed at the date of reclassification and anticipated average effective interest rate (EIR) over the remaining life of the assets:

| (CZKm) | Debt sovereign bonds | Mortgage bonds | Total |
|---|---|---|---|
| Expected undiscounted cash recoveries, as assessed at the date of reclassification | 15,135 | 86,007 | 101,142 |
| Anticipated average EIR over the remaining life of the assets | 3.5% | 2.0% | |

In June 2016, the merger of Visa Europe Ltd. and Visa Inc. took place. A settlement of the sales price was divided into three tranches: cash payment, transfer of preferred shares of Visa Inc. and further cash payment in 2019. In June 2016, the Bank received a cash consideration in the amount of CZK 977 m as the first tranche.

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

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

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

The following table shows a reconciliation of the cumulative impairment losses on financial investments for 2016 and 2017:

| | Available-for-sale financial assets | Held-to-maturity investments | Total |
|---|---|---|---|
| (CZKm) | Equity securities | Debt securities | |
| **At 1 January 2016** | **79** | **-** | **79** |
| Utilisation | (29) | - | (29) |
| **At 31 December 2016** | **50** | **-** | **50** |
| Increase | 1 | 2 | 3 |
| Merger with subsidiaries Centrum Radlická and Patria Online (Note: 18) | 30 | - | 30 |
| Utilisation | (24) | - | (24) |
| **At 31 December 2017** | **57** | **2** | **59** |

## 17. LOANS AND RECEIVABLES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Analysed by category of borrower** | | |
| Central banks | 475,047 | 235,003 |
| General government | 5,857 | 6,188 |
| Credit institutions | 217,650 | 192,989 |
| Other legal entities | 234,668 | 226,929 |
| Private individuals | 47,088 | 43,425 |
| Gross loans | 980,310 | 704,534 |
| Allowance for impairment losses | (6,297) | (6,595) |
| | **974,013** | **697,939** |

Balances with central banks contain reverse repo transactions provided to central bank in the amount of CZK 475,047 m at 31 December 2017 (31 December 2016: CZK 235,003 m).

## 18. INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

Direct ownership of the Bank (%) in significant subsidiaries, associates and joint ventures was as follows:

| | | 2017 | | 2016 | |
|---|---|---|---|---|---|
| Name | Abbreviation | (%) | Carrying amount | (%) | Carrying amount |
| **Subsidiaries** | | | | | |
| Bankovní informační technologie, s.r.o. | BANIT | 100.00 | 60 | 100.00 | 60 |
| Centrum Radlická a.s. | Centrum Radlická | - | - | 100.00 | 709 |
| ČSOB Advisory, a.s. | ČSOB Advisory | 100.00 | 1,458 | 100.00 | 1,458 |
| ČSOB Factoring, a.s. | ČSOB Factoring | 100.00 | 1,275 | 100.00 | 1,145 |
| ČSOB Leasing, a.s. | ČSOB Leasing | 100.00 | 8,000 | 100.00 | 7,100 |
| ČSOB Penzijní společnost, a. s., a member of the ČSOB group | ČSOB PS | 100.00 | 1,475 | 100.00 | 1,475 |
| ČSOB Property fund, a.s. | ČSOB Property fund | - | - | 59.79 | 280 |
| Hypoteční banka, a.s. | Hypoteční banka | 100.00 | 35,129 | 100.00 | 31,127 |
| Patria Corporate Finance, a.s. | Patria CF | 100.00 | 16 | - | - |
| Patria Finance, a.s. | Patria Finance | 100.00 | 225 | - | - |
| Patria Online, a.s. | Patria Online | - | - | 100.00 | 955 |
| Radlice Rozvojová, a.s. | Radlice Rozvojová | 100.00 | 786 | 100.00 | 366 |
| **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 | 40.08 | 19 | 40.08 | 19 |
| ČSOB Pojišťovna, a. s., a member of the ČSOB holding | ČSOB Pojišťovna | 0.24 | 9 | 0.24 | 9 |
| | | | **49,992** | | **46,243** |

All companies are incorporated in the Czech Republic.

**Merger of the companies ČSOB, Centrum Radlická and Patria Online**

On 17 May 2017, the Board of Directors agreed on the intention to merge the ČSOB, a. s. (as a successor company) with its fully controlled subsidiaries Centrum Radlická, a.s. and Patria Online, a.s. (companies that cease to exist). The merger was finalised on 1 December 2017 when the local merger was entered into the Register of Companies.

The transaction was assessed as a business combination of companies under common control. Business combinations of companies under common control are not in scope of the IFRS 3 - Business combinations or any other standard.

Such a combination is reported in the separate financial statements of the Bank using the predecessor amount method with the effective date of the merger on 1 December 2017. Based on the accounting policies of the Bank and according to the predecessor amount method, assets and liabilities of Centrum Radlická and Patria Online are acquired by the Bank at their carrying amounts as reported by the merged companies.

As a result of the merger, an investment of the Bank in its subsidiaries Centrum Radlická in the amount of CZK 2,309 m and Patria Online in the amount of CZK 955 m was derecognised. On the other hand, Patria CF and Patria Finance, formerly subsidiaries of Patria Online, were recognised as new direct investments of the Bank in the amount of CZK 16 m, and CZK 225 m respectively.

The difference between the investments in subsidiaries and carrying amount of the merged assets and liabilities reached the amount of CZK 824 m and was recognised in the Bank’s Equity.

Set out below is an analysis of financial effect of the merger on the financial statements of the Bank as at 31 December 2017:

***Assets acquired and liabilities assumed***

| (CZKm) | Centrum Radlická | Patria Online | Eliminations of Centrum Radlická | Eliminations of Patria Online | 1 December 2017 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with central banks and other demand deposits | 92 | 16 | (92) | (16) | - |
| Available-for-sale financial assets | - | 18 | - | - | 18 |
| Share in Group companies | - | 271 | (2,309) | (955) | (2,993) |
| Deferred tax assets (Note: 12) | 71 | - | - | - | 71 |
| Property and equipment (Note: 20) | 2,070 | - | - | - | 2,070 |
| Goodwill and other intangible assets (Note: 21) | 1 | - | - | - | 1 |
| Other assets | - | 2 | (16) | - | (14) |
| **Total assets** | **2,234** | **307** | **(2,417)** | **(971)** | **(847)** |
| **LIABILITIES** | | | | | |
| Financial liabilities at amortised cost | - | - | (92) | (16) | (108) |
| Current tax liabilities | 10 | - | - | - | 10 |
| Other liabilities | 53 | 38 | (16) | - | 75 |
| **Total liabilities** | **63** | **38** | **(108)** | **(16)** | **(23)** |
| **Total identifiable net assets** | **2,171** | **269** | **(2,309)** | **(955)** | **(824)** |

In April 2017, the Bank increased its investment in Hypoteční banka by CZK 4,000 m through an additional charge apart from the registered capital of the company.

In June 2017, the Bank increased its investment in ČSOB Leasing by CZK 900 m through an additional charge apart from the registered capital of the company.

In June 2017, the Bank increased its investment in ČSOB Factoring by CZK 130 m through an additional charge apart from the registered capital of the company.

In June 2017, the Bank increased its investment in Centrum Radlická by CZK 1,600 m through an additional charge apart from the registered capital of the company.

In December 2017, the Bank increased its investment in Radlice Rozvojová by CZK 420 m through an additional charge apart from the registered capital of the company.

Additional payments for the squeeze-out of minority interest in Hypoteční banka in 2017 resulted in an increase of the carrying amount of the interest of CZK 2 m.

In March 2016, the Bank increased its investment in Radlice Rozvojová by CZK 55 m through an additional charge apart from the registered capital of the company.

In June 2016, a redemption of the other capital funds from ČSOB AM in the amount of CZK 27 m was processed.

Additional payments for the squeeze-out of minority interest in Hypoteční banka in 2016 resulted in an increase of the carrying amount of the interest of CZK 1 m.

In August 2016, the Bank increased its investment in ČSOB Factoring by CZK 50 m through an additional charge apart from the registered capital of the company.

In September 2016, the Bank increased its investment in Hypoteční banka by CZK 350 m through an additional charge apart from the registered capital of the company.

In December 2016, the Bank increased its investment in Radlice Rozvojová by CZK 40 m through an additional charge apart from the registered capital of the company.

In December 2016, the Bank decreased its investment in ČSOB PS by CZK 150 m through the redemption of other capital funds of the company.

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

Based on the Agreement on the exercise of voting rights, the Bank was entitled to a total of 95.67% of the voting rights in its subsidiary ČSOB Property fund in 2016. In December 2017, the Bank liquidated ČSOB Property Fund as a result of the earlier decision of the Bank to terminate its real estate activities. Liquidation balance received amounted to CZK 276 m.

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 2016 and 2017, the Bank considered the value of interests in certain subsidiaries to be impaired.

In 2017, 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 3 m, has been recognised. In December 2017, the whole amount of accumulated impairment loss was settled following the liquidation of the company.

In 2017, the whole amount of accumulated impairment loss of the Bank's interest in Patria Online was settled as a result of the merger with ČSOB.

In 2016, with regard to the equity decrease and increased discounted projected cash flows the impairment of interests in ČSOB PS was reversed in the amount of CZK 358 m.

In 2016, the value of interests in Patria Online was impaired as a result of the distribution of retained earnings to ČSOB. The provision for an impairment loss of CZK 225 m, has been recognised.

In 2016, with regard to sale of a building controlled by ČSOB Property fund, the impairment of interests in ČSOB Property fund was reversed in the amount of CZK 18 m.

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 2016 and 2017:

| (CZKm) | ČSOB PS | ČSOB Property fund | Patria Online | Total |
|---|---|---|---|---|
| **At 1 January 2016** | **358** | **264** | **-** | **622** |
| Increase (Note: 11) | - | - | 225 | 225 |
| Decrease (Note: 11) | (358) | (18) | - | (376) |
| **At 31 December 2016** | **-** | **246** | **225** | **471** |
| Increase (Note: 11) | - | 3 | - | 3 |
| Utilisation | - | (249) | - | (249) |
| Merger ČSOB with Patria Online | - | - | (225) | (225) |
| **At 31 December 2017** | **-** | **-** | **-** | **-** |

## 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 2017 and 2016 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***

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 574,520 | 7,558 | 8,066 | 552,066 | 8,868 | 10,109 |
| Forwards | 49,994 | 1 | 13 | 16,700 | 2 | - |
| Options | 25,045 | 64 | 36 | 47,043 | 94 | 105 |
| | **649,559** | **7,623** | **8,115** | **615,809** | **8,964** | **10,214** |
| **Foreign exchange contracts** | | | | | | |
| Swaps / Forwards | 374,585 | 2,137 | 3,921 | 161,563 | 1,182 | 452 |
| Cross currency interest rate swaps | 73,241 | 894 | 556 | 59,440 | 1,029 | 677 |
| Options | 106,668 | 1,024 | 1,046 | 74,236 | 571 | 569 |
| | **554,494** | **4,055** | **5,523** | **295,239** | **2,782** | **1,698** |
| **Equity contracts** | | | | | | |
| Swaps | 5,124 | 110 | 67 | 5,360 | 118 | 92 |
| Options | 6,304 | 297 | 30 | 3,231 | 163 | 23 |
| | **11,428** | **407** | **97** | **8,591** | **281** | **115** |
| **Commodity contracts** | | | | | | |
| Swaps / Options | 2,719 | 139 | 133 | 3,383 | 152 | 144 |
| **Total trading derivatives (Notes: 15, 24)** | **1,218,200** | **12,224** | **13,868** | **923,022** | **12,179** | **12,171** |

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

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Interest rate related contracts** | | | | | | |
| Swaps | 182,999 | 1,095 | 2,064 | 148,337 | 463 | 217 |
| **Foreign exchange contracts** | | | | | | |
| Cross currency interest rate swaps | 4,573 | 187 | - | 6,430 | 376 | 58 |
| **Total derivatives used as economic hedges (Notes: 15, 24)** | **187,572** | **1,282** | **2,064** | **154,767** | **839** | **275** |

SEPARATE FINANCIAL STATEMENTS

**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 non-retail client current accounts (the variability in the interest paid on the client deposits is effectively hedged by the fixed rate payer/floating rate receiver swaps).
- to convert floating-rate client loans to fixed rates.

Cross currency interest rate swaps are used to hedge currency risk resulting from interest income accrued on foreign currency investment debt securities. These fixed and floating interest earning securities are included in Available-for-sale financial assets and in Held-to-maturity investments of the Bank's statement of financial position.

The contract or notional amounts and positive and negative fair values of the Bank's outstanding cash flow hedging derivatives as at 31 December 2017 and 2016 are set out as follows:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Notional | Fair value | | Notional | Fair value | |
| (CZKm) | amount | Positive | Negative | amount | Positive | Negative |
| **Cash flow hedges** | | | | | | |
| Single currency interest rate swaps | 104,802 | 2,793 | 1,716 | 106,722 | 5,150 | 2,476 |
| Cross currency interest rate swaps | 11,008 | 243 | 481 | 11,922 | 422 | 866 |
| **Total hedging derivatives** | **115,810** | **3,036** | **2,197** | **118,644** | **5,572** | **3,342** |

SEPARATE FINANCIAL STATEMENTS

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Interest income (Note: 29) | 752 | 929 |
| Net gains / (losses) from financial instruments at fair value through profit or loss (Note: 29) | 63 | 12 |
| Taxation (Note: 12) | (155) | (179) |
| **Net gains** | **660** | **762** |

In 2017, a gain of CZK 50 m was recognised in the statement of income due to hedge ineffectiveness from cash flow hedges (2016: CZK 3 m).

In 2017, the discontinuation of hedge accounting (due to sales of / impairment on underlying hedged bonds or retrospective hedge effectiveness test failure) resulted in a reclassification of the associated cumulative gains of CZK 13 m from equity to the statement of income (2016: CZK 10 m). The gains / losses are included in Net gains from financial instruments at fair value through profit or loss.

Since the cash flows from the hedging interest rate swaps are variable and difficult to predict, the Bank uses the remaining contractual maturity analysis of the hedging derivatives notional amounts instead of the expected future cash flows from the hedged items. As the objective of the hedging structure is to achieve fixed interest income, the information of the hedging swaps notional amounts remaining maturity is more relevant. Cash flows from hedged items are expected to occur in the same periods as the remaining maturity of cash flows from hedging derivatives.

The following table shows the notional amounts of hedging derivatives by remaining contractual maturity at 31 December 2017 and 2016:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Less than 3 months | 3,313 | 5,810 |
| More than 3 months but not more than 6 months | 5,652 | 9,492 |
| More than 6 months but not more than 1 year | 11,873 | 7,820 |
| More than 1 year but not more than 2 years | 14,697 | 20,978 |
| More than 2 years but not more than 5 years | 55,740 | 58,348 |
| More than 5 years | 24,535 | 16,196 |
| | **115,810** | **118,644** |

**Fair value hedging derivatives**

Cross currency interest rate swaps are used to hedge both FX risks and interest rate risks arising from the movement in the fair value of foreign currency fixed rate bonds classified as Available-for-sale attributable to the changes in the FX rate and the risk-free (interest rate swap) yield curve. A fixed rate payer (foreign currency)/floating rate receiver (home currency) interest rate swap is expected to be a highly effective hedge.

Interest rate swaps are used by the Bank to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Available-for-sale attributable to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be highly effective hedge.

Fair value hedges for portfolios of retail non-maturity deposits have been used to hedge interest rate risk arising from changes in fair value of non-maturity retail deposits to changes in the risk-free yield curve. The portfolio consisting of the part of retail current accounts was designated as a hedged item. The interest rate risk is effectively hedged by the single currency fixed rate receiver/floating rate payer swaps.

Fair value hedges for portfolios of fixed rate loans have been used to hedge interest rate risk arising from changes in the fair value of fixed rate loans to changes in the risk-free yield curve. The interest rate risk is effectively hedged by the single currency fixed rate payer/floating rate receiver swaps.

Fair value hedges for portfolios of fixed rate mortgage bonds classified as Available-for-sale have been used to hedge interest rate risk arising from changes in the fair value of fixed rate bonds to changes in the risk-free yield curve. The interest rate risk is effectively hedged by the single currency fixed rate payer/floating rate receiver swaps.

Interest rate swaps are used by the Bank to hedge the interest rate risk arising from the movement in the fair value of bonds classified as Loans and receivables, i.e. private issues without active secondary market, to changes in the risk-free (interest rate swap) yield curve. A fixed payer/floating rate receiver interest rate swap denominated in the same currency as the hedged bond is expected to be a highly effective hedge.

The contract or notional amounts and positive and negative fair values of the Bank's outstanding fair value hedging derivatives as at 31 December 2017 and 2016 are set out as follows:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | 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 | 55,304 | 105 | 3,001 | 51,012 | 36 | 5,117 |
| Fair value portfolio hedges | 396,279 | 5,307 | 5,198 | 314,372 | 6,015 | 1,888 |
| *Cross currency interest rate swaps* | | | | | | |
| Fair value micro hedges | 923 | - | 77 | 516 | - | 71 |
| **Total hedging derivatives** | **452,506** | **5,412** | **8,276** | **365,900** | **6,051** | **7,076** |

In 2017, the discontinuation of hedge accounting due to sales of underlying hedged bonds resulted in realised losses of CZK 159 m (2016: CZK Nil) included in Net gains from financial instruments at fair value through profit or loss in the statement of income.

In 2017, the net gains in the amount of CZK 2,705 m (2016: losses of CZK 724 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 2,535 m (2016: gains of CZK 679 m).

## 20. PROPERTY AND EQUIPMENT

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2016 | 4,392 | 511 | 549 | 1,334 | 112 | 6,898 |
| Depreciation and impairment at 1 January 2016 | (2,569) | (97) | (445) | (1,022) | - | (4,133) |
| **Net book value at 1 January 2016** | **1,823** | **414** | **104** | **312** | **112** | **2,765** |
| Transfers | 149 | 340 | 19 | 71 | (579) | - |
| Additions | - | - | - | - | 770 | 770 |
| Disposals | (23) | (1) | (3) | (8) | - | (35) |
| Depreciation | (187) | (177) | (29) | (92) | - | (485) |
| Impairment | (9) | - | - | - | - | (9) |
| **Net book value at 31 December 2016** | **1,753** | **576** | **91** | **283** | **303** | **3,006** |
| of which | | | | | | |
| Cost | 4,431 | 851 | 546 | 1,335 | 303 | 7,466 |
| Depreciation and impairment | (2,678) | (275) | (455) | (1,052) | - | (4,460) |

| (CZKm) | Land and buildings | IT equipment | Office equipment | Other | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2017 | 4,431 | 851 | 546 | 1,335 | 303 | 7,466 |
| Depreciation and impairment at 1 January 2017 | (2,678) | (275) | (455) | (1,052) | - | (4,460) |
| **Net book value at 1 January 2017** | **1,753** | **576** | **91** | **283** | **303** | **3,006** |
| Transfers | 324 | 275 | 51 | 104 | (754) | - |
| Additions | - | - | - | - | 838 | 838 |
| Disposals | (14) | (5) | (3) | (11) | - | (33) |
| Merger of ČSOB, Centrum Radlická and Patria Online (Note: 18) | 2,029 | - | - | 41 | - | 2,070 |
| Transfer to non-current assets held-for-sale | (6) | - | - | - | - | (6) |
| Depreciation | (251) | (252) | (26) | (95) | - | (624) |
| Impairment | (6) | - | - | - | - | (6) |
| **Net book value at 31 December 2017** | **3,829** | **594** | **113** | **322** | **387** | **5,245** |
| of which | | | | | | |
| Cost | 7,403 | 1,112 | 567 | 1,554 | 387 | 11,023 |
| Depreciation and impairment | (3,574) | (518) | (454) | (1,232) | - | (5,778) |

As a result of the merger of ČSOB, Centrum Radlická and Patria Online (Note: 18), the Bank acquired a building of the ČSOB Group's headquarter in the carrying amount of CZK 2,029 m and other property of CZK 41 m.

Property and equipment are assessed as non-current assets.

## 21. GOODWILL AND OTHER INTANGIBLE ASSETS

| (CZKm) | Goodwill | Acquired software | Internally developed software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2016 | 2,752 | 4,124 | - | 754 | 544 | 8,174 |
| Amortisation and impairment at 1 January 2016 | (63) | (2,339) | - | (713) | - | (3,115) |
| **Net book value at 1 January 2016** | **2,689** | **1,785** | **-** | **41** | **544** | **5,059** |
| Transfers | - | 59 | - | 35 | (94) | - |
| Additions | - | - | - | - | 738 | 738 |
| Disposals | - | (12) | - | - | - | (12) |
| Amortisation | - | (450) | - | (12) | - | (462) |
| Impairment | - | (14) | - | - | (60) | (74) |
| **Net book value at 31 December 2016** | **2,689** | **1,368** | **-** | **64** | **1,128** | **5,249** |
| of which | | | | | | |
| Cost | 2,752 | 4,394 | - | 530 | 1,188 | 8,864 |
| Amortisation and impairment | (63) | (3,026) | - | (466) | (60) | (3,615) |

| (CZKm) | Goodwill | Acquired software | Internally developed software | Other intangible assets | Construction in progress | Total |
|---|---|---|---|---|---|---|
| Cost at 1 January 2017 | 2,752 | 4,394 | - | 530 | 1,188 | 8,864 |
| Amortisation and impairment at 1 January 2017 | (63) | (3,026) | - | (466) | (60) | (3,615) |
| **Net book value at 1 January 2017** | **2,689** | **1,368** | **-** | **64** | **1,128** | **5,249** |
| Transfers | - | 43 | 1,494 | - | (1,537) | - |
| Additions | - | - | - | - | 762 | 762 |
| Disposals | - | - | - | (12) | - | (12) |
| Merger with subsidiaries Centrum Radlická and Patria Online (Note: 18) | - | 1 | - | - | - | 1 |
| Amortisation | - | (420) | (81) | (14) | - | (515) |
| Impairment | - | (190) | - | - | - | (190) |
| **Net book value at 31 December 2017** | **2,689** | **802** | **1,413** | **38** | **353** | **5,295** |
| of which | | | | | | |
| Cost | 2,752 | 4,254 | 1,494 | 480 | 353 | 9,333 |
| Amortisation and impairment | (63) | (3,452) | (81) | (442) | - | (4,038) |

Included in Construction in progress is internally developed software in the net amount of CZK 353 m as at 31 December 2017 (31 December 2016: CZK 1,116 m).

Goodwill and other intangible assets are assessed as non-current assets.

Goodwill has been allocated to the Retail segment and SME clients, representing a cash-generating unit (CGU). The recoverable amount for the Retail segment and SME clients was determined based on the value-in-use methodology. The calculation uses cash flow projections from business plans for the forthcoming four years which are then extrapolated for a five further years using the expected average growth rate of 3%; after that a terminal value is applied.

Cash flows in the Retail segment and SME clients are based on the net profit generated by the CGU above the required capital and a terminal value of the business. For the calculation of the terminal value a sustainable discount rate of 10.1% in 2017 (2016: 10.1%) and no long term growth rates were used in 2017 and 2016.

The value in use is particularly sensitive to a number of key assumptions:

- The growth rate in forecasted cash flows beyond the terminal year of the budget. The Bank has a conservative approach when calculating the terminal value, which implies that no growth rate for Retail segment and SME clients has been used for extrapolation purposes beyond the budget period.
- The risk discount rate. For Retail segment and SME clients an average risk discount rate of 10.3% has been applied (2016: 10.0%). This reflects a risk-free rate in the Eurozone, long-term inflation in the Czech market and in the Eurozone, the credit default swap spread for the Czech Republic relative to the Eurozone, an average 'beta' factor for relative market risk, including the market risk premium.

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

The outcome of the impairment assessment was that it is considered unlikely that goodwill in respect of the Retail segment and SME clients would be impaired given that the value-in-use is significantly higher than the carrying value of goodwill.

The management believes that reasonable potential changes in the key assumptions on which the recoverable amount is based would not cause it to fall below the carrying amount.

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

| (CZKm) | Land and buildings | Total |
|---|---|---|
| **Net book value at 1 January 2016** | **66** | **66** |
| Additions | 1 | 1 |
| Disposal | (32) | (32) |
| **Net book value at 31 December 2016** | **35** | **35** |
| of which | | |
| Cost | 44 | 44 |
| Impairment | (9) | (9) |

| (CZKm) | Land and buildings | Total |
|---|---|---|
| **Net book value at 1 January 2017** | **35** | **35** |
| Transfers from Property and equipment | 6 | 6 |
| Disposal | (41) | (41) |
| **Net book value at 31 December 2017** | **-** | **-** |
| of which | | |
| Cost | - | - |
| Impairment | - | - |

Movements disclosed in Transfer from Property and equipment represent buildings and other property which were decided to be sold. The buildings were measured at the lower of their carrying amount and fair value less costs to sell. The fair value of the buildings was calculated based on indicative market prices.

The impairment losses resulting from the decreased recoverable amount of the buildings were caused by a decrease of expected future cash-flows less costs to sell.

## 23. OTHER ASSETS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Other debtors, net of provisions (Notes: 30, 32, 35, 38.2) | 534 | 675 |
| Prepaid charges | 260 | 229 |
| Accrued income (Notes: 30, 32, 35, 38.2) | 123 | 117 |
| VAT and other tax receivables | 9 | 9 |
| | **926** | **1,030** |

Other assets are assessed as current assets.

## 24. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Financial liabilities held for trading** | | |
| Short positions | 12,952 | 13,025 |
| Derivative contracts (Note: 19) | | |
| Trading derivatives | 13,868 | 12,171 |
| Derivatives used as economic hedges | 2,064 | 275 |
| Term deposits | 362 | 3,184 |
| Repo transactions | 2,097 | - |
| Bonds and investment certificates issued | 5,317 | 11,413 |
| | **36,660** | **40,068** |
| **Financial liabilities designated at fair value through profit or loss** | | |
| Investment certificates | 9,498 | 1,620 |
| | **9,498** | **1,620** |
| **Financial liabilities at fair value through profit or loss** | **46,158** | **41,688** |

The amount that the Bank would contractually be required to pay at the maturity of the financial liabilities designated at fair value through profit or loss is CZK 52 m less than the carrying amount at 31 December 2017 (31 December 2016: CZK 73 m).

The changes in the fair value of the Financial liabilities designated at fair value through profit or loss attributable to changes in own credit risk were not significant.

Included in Financial liabilities designated at fair value through profit or loss are debt instruments containing an embedded derivative.

## 25. FINANCIAL LIABILITIES AT AMORTISED COST

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Deposits received from credit institutions** | | |
| Current accounts and overnight deposits | 36,146 | 9,114 |
| Term deposits | 15,237 | 18,844 |
| Repo transactions | 22,011 | 9,452 |
| | **73,394** | **37,410** |
| **Deposits received from other than credit institutions** | | |
| Current accounts and overnight deposits | 506,247 | 441,984 |
| Term deposits | 11,806 | 8,299 |
| Savings deposits | 214,976 | 214,689 |
| Other deposits | 8,979 | 9,107 |
| | **742,008** | **674,079** |
| **Debt securities in issue** | | |
| Bonds and investment certificates issued | 501 | 501 |
| Promissory notes | 329,985 | 197,644 |
| | **330,486** | **198,145** |
| **Financial liabilities at amortised cost** | **1,145,888** | **909,634** |

## 26. OTHER LIABILITIES

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Payables to employees including social security charges (Notes: 30, 32, 35, 38.3) | 1,908 | 1,889 |
| Accrued charges (Notes: 30, 32, 35, 38.3) | 1,259 | 1,551 |
| Other creditors (Notes: 30, 32, 35, 38.3) | 100 | 374 |
| Income received in advance | 59 | 114 |
| VAT and other tax payables | 113 | 87 |
| | **3,439** | **4,015** |

Other liabilities are assessed as current liabilities.

## 27. PROVISIONS

| (CZKm) | Pending legal issues and other losses | Restructuring | Contractual engagements | Loan commitments and guarantees (Note: 33) | Total |
|---|---|---|---|---|---|
| **At 1 January 2016** | **81** | **100** | **45** | **285** | **511** |
| Additions | 331 | - | 27 | 141 | 499 |
| Amounts utilised | (54) | (51) | (35) | - | (140) |
| Unused amounts reversed | (17) | - | (8) | (194) | (219) |
| Discount amortisation (Note: 5) | - | - | 3 | - | 3 |
| **At 31 December 2016** | **341** | **49** | **32** | **232** | **654** |
| Additions | 74 | - | 9 | 345 | 428 |
| Amounts utilised | (10) | (37) | (21) | - | (68) |
| Unused amounts reversed | (37) | - | (5) | (109) | (151) |
| Discount amortisation (Note: 5) | - | - | 3 | - | 3 |
| Foreign currency translation | - | - | - | (2) | (2) |
| **At 31 December 2017** | **368** | **12** | **18** | **466** | **864** |

*Restructuring*

During 2015, the Bank started a restructuring programme, resulting in the creation of a provision of CZK 100 m. In the framework of this restructuring programme the total number of personnel were reduced in 2016 and 2017.

*Pending legal issues and other losses*

Provisions for legal issues and other losses represent an obligation to cover potential risks resulting from litigation, where the Bank is the defendant.

The Bank is involved in a number of ongoing legal disputes, the resolution of which may have an adverse financial impact on the Bank. Based upon historical experience and expert reports, the Bank assesses the developments in these cases, and the likelihood and the amount of potential financial losses which are appropriately provided for.

The Bank's policy is to create a provision, where the possibility of an outflow of resources embodying economic benefits to settle the obligation is more than 50%. In such cases the Bank creates a provision in the full amount to cover the possible cost in the event of loss.

In 2017, the Bank had a provision for pending legal issues and other losses in the total amount of CZK 368 m. It is expected that the majority of the costs will be incurred in the next 3 years.

On a quarterly basis, the Bank monitors the status of all cases and makes a decision as to whether to create, utilise or reverse any provision.

The Bank does not disclose the details underlying the disputes as the disclosure may have an impact on the outcome of the disputes and may seriously harm the Bank's interests.

*Contractual engagements*

A number of leasehold property arrangements for which, on a net basis, the unavoidable contractual rental costs exceeds normal market rental conditions exists in the Bank. This provision represents the present value of the future net rental losses that will arise. It is expected that the majority of costs will be incurred over the next 3 years.

## 28. SHARE CAPITAL AND OTHER RESERVES

As at 31 December 2017, the total authorised share capital was CZK 5,855 m (31 December 2016: CZK 5,855 m) and comprised of 292,750,002 ordinary shares with a nominal value of CZK 20 each (31 December 2016: 292,750,002 ordinary shares with a nominal value of CZK 20 each) and is fully paid up.

No Treasury shares were held by the Bank at 31 December 2017 and 2016.

On 31 December 2017, the Bank was directly controlled by KBC Bank whose ownership interest in ČSOB was 100% (31 December 2016: 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 2017 and 2016:

| (CZKm) | Available-for-sale reserve | Cash flow hedge reserve | Total |
|---|---|---|---|
| **At 1 January 2016** | **3,296** | **2,646** | **5,942** |
| Other comprehensive income (Note: 29) | (1,452) | (673) | (2,125) |
| **At 31 December 2016** | **1,844** | **1,973** | **3,817** |
| Other comprehensive income (Note: 29) | (476) | (1,476) | (1,952) |
| **At 31 December 2017** | **1,368** | **497** | **1,865** |

## 29. COMPONENTS OF OTHER COMPREHENSIVE INCOME

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Cash flow hedges** | | |
| Net unrealised (loss) / gains on cash flow hedges | (1,001) | 110 |
| Net gains on cash flow hedges reclassified to the statement of income (Note: 19) | (815) | (941) |
| Tax effect relating to cash flow hedges (Note: 12) | 340 | 158 |
| | (1,476) | (673) |
| **Available-for-sale financial assets** | | |
| Net unrealised losses on available-for-sale financial investments | (12) | (322) |
| Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal | (455) | (1,295) |
| Net realised gains on available-for-sale financial investments amortised to the statement of income on reclassified assets (Note: 16) | (121) | (176) |
| Tax effect relating to available-for-sale financial investments (Note: 12) | 112 | 341 |
| | (476) | (1,452) |
| **Other comprehensive income for the year, net of tax, to be reclassified to statement of income in subsequent periods** | **(1,952)** | **(2,125)** |

In 2016, net gain of CZK 1,295 m resulting from the transaction of merger Visa Inc. and Visa Europe Ltd. is reported as part of Net realised gains on available-for-sale financial investments reclassified to the statement of income on disposal.

## 30. FAIR VALUE OF FINANCIAL INSTRUMENTS

**Financial assets and liabilities at fair value**

The Bank's accounting policy on fair value measurements is discussed in the Accounting policies (Note 2.4 (4)).

Financial assets and liabilities at fair value (available-for-sale, held for trading, designated at fair value through profit or loss) are valued as follows:

- Level 1

  If available, published price quotations in active markets are used to determine the fair value of financial assets or financial liabilities. Revaluation is obtained using prices of an identical asset or liability, which means that no model is involved in the process of a revaluation. Financial instruments valued on this basis include spot foreign exchange contracts and listed shares and bonds.

  Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques.

- Level 2

  Valuation techniques based on observable inputs, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observed from the market.

  Financial instruments valued on this basis include forward interest rate, foreign exchange and commodity contracts, mortgage bonds, money market loans and deposits.

- Level 3

  Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

  Financial instruments for which the parameters are not observable include unlisted shares, a part of the portfolio of trading derivatives, a part of the portfolio of mortgage bonds and selected listed but not traded bonds.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to determine a fair value that reflects the price of the financial instrument at the reporting date, that would have been determined by market participants acting at arm's length.

The Bank uses widely recognised valuation models for determining the fair value of common and less complex financial instruments like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter derivatives like interest rate swaps. The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Bank uses proprietary valuation models, which are usually developed from recognised valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Examples of instruments involving significant unobservable inputs include certain over-the-counter structured derivatives, certain loans and securities for which there is no active market. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, the determination of expected future cash flows on the financial instrument being valued, the determination of the probability of counterparty default and prepayments and the selection of appropriate discount rates. The Valuation policy is subject to approval of the ČSOB Risk and Capital Oversight Committee and KBC Group Valuation Committee. The process for the approval of any new product consist also of an assessment of the valuation of the product and the eventual new valuation model for the product has to be approved before the product is endorsed or approval of the model is a blocking condition for the product implementation. The New and Active Product Process also requires a regular review of all products and the assessment of valuation quality is an important part of the review. Any valuation model, which uses not directly observable inputs, is subject to the Parameter review policy. The policy requires quarterly assessment of all parameters correctness. The Bank currently checks the valuation of all bonds quarterly.

The Bank also monitors the quality of asset valuations on a daily basis. If an asset quote quality does not meet the required criteria for Level 1 or level 2 the asset is transferred to Level 3 and vice versa. The monitoring process evaluates among others the frequency of quote updates.

The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2017:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | - | - | - |
| Debt instruments | 133 | 319 | 3,716 | 4,168 |
| Derivative contracts | - | 13,306 | 200 | 13,506 |
| Financial assets held for trading pledged as collateral | | | | |
| Debt instruments | 1,901 | 196 | - | 2,097 |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | - | - | 3,376 | 3,376 |
| Available-for-sale financial assets | | | | |
| Debt securities | 27,445 | 231 | 20,647 | 48,323 |
| Equity securities | - | - | 454 | 454 |
| Available-for-sale financial assets pledged as collateral | | | | |
| Debt securities | 3,118 | - | 2,729 | 5,847 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (3,483) | - | (3,483) |
| Derivatives used for hedging | - | 8,448 | - | 8,448 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 12,952 | - | - | 12,952 |
| Derivative contracts | - | 15,852 | 80 | 15,932 |
| Term deposits | - | 362 | - | 362 |
| Repo transactions | - | 2,097 | - | 2,097 |
| Bonds issued | - | 5,317 | - | 5,317 |
| Financial liabilities designated at fair value | | | | |
| Investment certificates | - | 2,545 | 6,953 | 9,498 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (3,803) | - | (3,803) |
| Derivatives used for hedging | - | 10,473 | - | 10,473 |

The following table shows an analysis of financial instruments recorded at fair value, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets recorded at fair value** | | | | |
| Financial assets held for trading | | | | |
| Loans and advances | - | 15 | - | 15 |
| Debt instruments | 2,507 | 794 | 4,814 | 8,115 |
| Derivative contracts | - | 12,918 | 100 | 13,018 |
| Financial assets held for trading pledged as collateral | | | | |
| Debt instruments | 568 | - | - | 568 |
| Financial assets designated at fair value through profit or loss | | | | |
| Debt instruments | - | - | 3,485 | 3,485 |
| Available-for-sale financial assets | | | | |
| Debt securities | 37,825 | 21,318 | 10,505 | 69,648 |
| Equity securities | - | - | 342 | 342 |
| Available-for-sale financial assets pledged as collateral | | | | |
| Debt securities | 1,009 | - | 2,068 | 3,077 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 797 | - | 797 |
| Derivatives used for hedging | - | 11,623 | - | 11,623 |
| **Financial liabilities recorded at fair value** | | | | |
| Financial liabilities held for trading | | | | |
| Short positions | 13,025 | - | - | 13,025 |
| Derivative contracts | - | 12,304 | 142 | 12,446 |
| Term deposits | - | 3,184 | - | 3,184 |
| Bonds issued | - | 11,413 | - | 11,413 |
| Financial liabilities designated at fair value | | | | |
| Investment certificates | - | 1,620 | - | 1,620 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 4,796 | - | 4,796 |
| Derivatives used for hedging | - | 10,418 | - | 10,418 |

Yield curve used in the mortgage bonds valuation model for discounting future cash flows curves is constructed from IRS rates and respective credit spreads. The credit spreads are derived from available market quotes of mortgage bonds, governments bonds and IRS rates.

The spreads for the first year of maturity were exclusively derived from market observable quotes of mortgage bonds. Therefore mortgage bonds with a maturity of up to one year are included in Level 2. The spread for the rest of the curve are derived from observed mortgage bond spread at one year and slope of the Czech government yield curve. The management considers this a significant market unobservable input, and as a consequence, the mortgage bonds with a maturity of longer than one year are reported as part of Level 3.

The spread according to bond maturity was 96 bps (7-year) to 182 bps (above 30-year) in 2016 and 74 bps (2-year) to 102 bps (20-year) in 2017.

Valuation of bonds issued by Česká Exportní Banka (ČEB) is based on model using unobservable inputs. Yield curves (different for floating and fix bonds) used in the ČEB bonds valuation model for discounting future cash flows are constructed from IRS rates and respective credit spreads. The credit spreads are derived from the quotes of the most liquid bonds issued by ČEB and IRS rates. The management considers this a significant market unobservable input and, as a consequence, the bonds issued by ČEB are classified as Level 3.

The spreads are regularly updated, at the latest quarterly. The spread according to bond maturity was 5 bps (1-year) to 210 bps (10-year) for fixed bonds and 9 bps (1-year) to 42 bps (10-year) for floating bonds after last review in December 2017 (2016: 16 bps (1-year) to 195 bps (10-year) for fixed bonds and 12 bps (1-year) to 53 bps (10-year)).

The Bank’s share in Visa Inc. classified as Available-for-sale financial asset is subject to fair value measurement based on the quoted price of Visa Inc.

All transfers of financial instruments among the levels of the fair value hierarchy are deemed to have occurred at the end of the reporting period.

### Movements in Level 3 financial instruments measured at fair value

The following table shows the reconciliation of the opening and closing amount of financial assets which are recorded at fair value using valuation techniques based on non-market observable inputs:

| (CZKm) | Financial assets held for trading – Trading derivatives | Financial assets held for trading – Debt securities | Financial assets designated at fair value through profit or loss – Debt securities | Available-for-sale financial assets (incl. assets pledged as collateral) – Debt securities | Available-for-sale financial assets (incl. assets pledged as collateral) – Equity securities | Total |
|---|---|---|---|---|---|---|
| **At 1 January 2016** | **89** | **5,714** | **3,491** | **4,388** | **1,304** | **14,986** |
| Total gains / (losses) recorded in profit or loss | 199 | 61 | (6) | (1) | - | 253 |
| Total gains recorded in other comprehensive income | - | - | - | 73 | 28 | 101 |
| Transfers into Level 3 | - | 1,470 | - | 8,147 | - | 9,617 |
| Transfers out of Level 3 | - | (814) | - | - | - | (814) |
| Purchases | - | 2,363 | - | - | 305 | 2,668 |
| Settlement | (188) | (991) | - | - | - | (1,179) |
| Sales | - | (2,989) | - | (34) | (1,295) | (4,318) |
| **At 31 December 2016** | **100** | **4,814** | **3,485** | **12,573** | **342** | **21,314** |
| Total gains recorded in profit or loss related to assets held at the end of the reporting period | 199 | 79 | (6) | (1) | - | **210** |
| **At 1 January 2017** | | | | | | |
| Total gains / (losses) recorded in profit or loss | 240 | (291) | (109) | (170) | - | (330) |
| Total gains recorded in other comprehensive income | - | - | - | (360) | 65 | (295) |
| Transfers into Level 3 | - | 58 | - | 9,829 | - | 9,887 |
| Transfers out of Level 3 | - | (76) | - | - | - | (76) |
| Merger with Patria Online (Note: 18) | - | - | - | - | 47 | 47 |
| Purchases | - | 1,424 | - | 1,613 | - | 3,037 |
| Settlement | (140) | (142) | - | - | - | (282) |
| Sales | - | (2,071) | - | (109) | - | (2,180) |
| **At 31 December 2017** | **200** | **3,716** | **3,376** | **23,376** | **454** | **31,122** |
| Total gains recorded in profit or loss related to assets held at the end of the reporting period | 240 | (281) | (109) | (170) | - | **(320)** |

Total gains recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss, Net realised gains on available-for-sale financial assets and Impairment losses of the statement of income.

Included in Transfers to level 3 in 2016 and 2017, there are available-for-sale debt securities for which remaining maturity depends on the prepayment option. Based on the valuation model, the mortgage bonds with the remaining maturity up to one year, taking into account the prepayment option, are reported as part of Level 2. If the prepayment option has not been called then the remaining maturity is prolonged over 1 year. Such a mortgage bond is then reported as Level 3 financial instrument.

The following table shows the reconciliation of the opening and closing amount of financial liabilities which are recorded at fair value using valuation techniques based on non-market observable inputs:

| (CZKm) | Financial liabilities held for trading – Trading derivatives | Financial liabilities designated at fair value through profit or loss – Investment certificates | Total |
|---|---|---|---|
| **At 1 January 2016** | **162** | **-** | **162** |
| Total losses recorded in profit or loss | 178 | - | 178 |
| Settlement | (198) | - | (198) |
| **At 31 December 2016** | **142** | **-** | **142** |
| Total losses recorded in profit or loss related to liabilities held at the end of the reporting period | 178 | - | 178 |
| **At 1 January 2017** | **142** | **-** | **178** |
| Total losses recorded in profit or loss | 72 | 37 | 109 |
| Issued | - | 6,916 | 6,916 |
| Settlement | (134) | - | (134) |
| **At 31 December 2017** | **80** | **6,953** | **7,033** |
| Total losses recorded in profit or loss related to liabilities held at the end of the reporting period | 72 | 37 | 109 |

Total losses recorded in profit or loss are included within the captions Net gains from financial instruments at fair value through profit or loss of the statement of income.

**Impact on fair value of Level 3 financial instruments measured at fair value of changes to key assumptions**

Management considers the value of the credit spread included in the discount factor applied on estimated future cash flows from the mortgage bonds in periods after the first 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 2017, an increase / (decrease) of the credit spread by 50 basis points would (decrease) / increase the fair value of the mortgage bonds and bonds issued by ČEB included in Level 3 by CZK 405 m and CZK 65 m, respectively (2016: CZK 267 m and CZK 84 m, respectively). Such a change in the credit spread is based on the variability of mortgage bond and ČEB bond quotes that were observed by the management on the market.

Management believes that reasonably possible changes in other non-observable market inputs in the valuation models used would not have a material impact on the estimated fair values.

**Transfers between Level 1 and 2 of the fair value hierarchy for financial instruments**

In 2016 and 2017, no transfers were made 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.

### Financial assets and liabilities not carried at fair value

Set out below is a comparison of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the financial statements:

| (CZKm) | 2017 Carrying value | 2017 Fair value | 2016 Carrying value | 2016 Fair value |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and balances with central banks and other demands deposits | 53,191 | 53,191 | 56,721 | 56,721 |
| Loans and receivables | 974,013 | 963,794 | 697,939 | 700,211 |
| Held-to-maturity investments | 86,604 | 95,483 | 116,626 | 135,265 |
| Held-to-maturity investments pledged as collateral | 29,017 | 30,814 | 16,053 | 16,434 |
| Other assets (Note: 23) | 657 | 657 | 792 | 792 |
| **Financial liabilities** | | | | |
| Financial liabilities at amortised cost | 1,145,888 | 1,148,386 | 909,634 | 913,934 |
| Other liabilities (Note: 26) | 3,267 | 3,267 | 3,814 | 3,814 |

The following table shows an analysis of financial instruments for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2017:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets for which fair values are disclosed** | | | | |
| Cash and balances with central banks and other demand deposits | 9,742 | 43,449 | - | 53,200 |
| Loans and receivables | - | 503,090 | 460,704 | 963,794 |
| Held-to-maturity investments | 93,190 | - | 2,293 | 95,483 |
| Held-to-maturity investments pledged as collateral | 30,814 | - | - | 30,814 |
| Other assets (Note: 23) | - | 657 | - | 657 |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Financial liabilities at amortised cost | - | 1,111,020 | 37,366 | 1,148,386 |
| Other liabilities (Note: 26) | - | 3,267 | - | 3,267 |

The following table shows an analysis of financial instruments for which fair values are disclosed, between those for which the fair value is based on quoted market prices and those for which the fair value is based on valuation techniques as at 31 December 2016:

| (CZKm) | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets for which fair values are disclosed** | | | | |
| Cash and balances with central banks and other demand deposits | 9,074 | 47,647 | - | 56,721 |
| Loans and receivables | - | 251,529 | 448,682 | 700,211 |
| Held-to-maturity investments | 132,854 | - | 2,411 | 135,265 |
| Held-to-maturity investments pledged as collateral | 16,434 | - | - | 16,434 |
| Other assets (Note: 23) | - | 792 | - | 792 |
| **Financial liabilities for which fair values are disclosed** | | | | |
| Financial liabilities at amortised cost | - | 885,496 | 28,438 | 913,934 |
| Other liabilities (Note: 26) | - | 3,814 | - | 3,814 |

The following methods and assumptions were applied in estimating the fair values of the Bank's financial assets and liabilities:

**Held-to-maturity investments**

Fair values for held-to-maturity securities are based on quoted market prices, where available. Such quotes are obtained from relevant exchanges, if exchange activity for the particular security is considered sufficiently liquid, or from reference rates averaging market maker quotes. If quoted market prices are not available, fair values are estimated from quoted market prices of comparable instruments or using the valuation model using discounted future cash flows.

**Loans and receivables to credit institutions and balances with central banks**

The carrying values of current account balances are equal to their fair values. The fair values of term placements with credit institutions and central banks are estimated by discounting their future cash flows using current interbank market rates, including the respective credit spread derived from the Bank's own experience of probability of default and loss given default. A majority of the loans reprice within relatively short time periods, therefore, it is assumed that their carrying values approximate their fair values.

**Loans and receivables to other than credit institutions**

A substantial majority of the loans to customers reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values. The fair values of fixed-rate loans to customers are estimated by discounting their future cash flows using current market rates including the respective credit spread derived from the Bank's own experience of probability of default and loss given default. Fair value incorporates expected future losses, while amortised cost and related impairment include only incurred losses at the end of the accounting period.

**Deposits received from credit institutions and subordinated liabilities**

The carrying values of current account balances are equal to their fair values. For other amounts due to credit institutions with equal to or less than one year remaining maturity, it is assumed that their carrying values approximate their fair values. The fair values of other amounts due to credit institutions are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spread.

**Deposits received from other than credit institutions**

The fair values of current accounts and term deposits, with equal to or less than one year remaining to maturity, approximate their carrying values. The fair values of other term deposits are estimated by discounting their future cash flows using IRS rates modified by market unobservable credit spreads.

### Debt securities in issue

The fair values of bonds issued are estimated by discounting their future cash flows using Czech government bond rates adjusted by credit spread derived from market observable transactions with respective or comparable bonds. The carrying values of promissory notes and certificates of deposit approximate their fair values.

### Other assets and other liabilities

A majority of other assets and liabilities have a remaining maturity equal to or less than one year or reprice within relatively short time periods; therefore, it is assumed that their carrying values approximate their fair values.

## 31. ADDITIONAL CASH FLOW INFORMATION

### Analysis of the balances of cash and cash equivalents as shown in the statement of financial position

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Cash and balances with central banks and other demand deposits (Note: 14) | 53,191 | 56,721 |
| Loans and advances to credit institutions and central banks | 477,336 | 237,894 |
| Financial liabilities at amortised cost to credit institutions and central banks | (36,275) | (9,818) |
| Financial liabilities at amortised cost – promissory notes issued to credit institutions | (310,147) | (196,782) |
| **Cash and cash equivalents** | **184,105** | **88,015** |

**Change in operating assets**

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Net change in financial assets held for trading (incl. assets pledged as collateral) | 1,945 | 8,935 |
| Net change in financial assets designated at fair value through profit or loss | 109 | 6 |
| Net change in available-for-sale financial assets (including assets pledged as collateral) | 16,905 | (3,518) |
| Net change in loans and receivables | (36,978) | (31,658) |
| Net change in derivatives used for hedging | 1,360 | (548) |
| Net change in other assets | 91 | 105 |
| | **(16,568)** | **(26,678)** |

**Change in operating liabilities**

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Net change in financial liabilities held for trading | (3,408) | 9,983 |
| Net change in financial liabilities designated at fair value through profit or loss | 7,877 | 1,620 |
| Net change in financial liabilities at amortised cost | 96,540 | 53,522 |
| Net change in derivatives used for hedging | 55 | (250) |
| Net change in other liabilities | (651) | 330 |
| | **100,413** | **65,205** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Depreciation and amortisation | 1,139 | 947 |
| Foreign exchange differences in held-to-maturity investments | 1,049 | (129) |
| Allowances and provisions for credit losses (Note: 11) | 255 | 498 |
| Impairment of intangible assets (Note: 11) | 190 | 74 |
| Impairment on property and equipment (Note: 11) | 6 | 9 |
| Impairment on investment securities (Note: 11) | 3 | - |
| Impairment on other assets (Note: 11) | (1) | 1 |
| Creation of provisions | (31) | 47 |
| Net change in fair value adjustments of the hedged items in portfolio hedge | (4,319) | 803 |
| Other | 449 | 197 |
| | **(1,260)** | **2,447** |

## 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 2017:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with Central banks and other demand deposits (Note: 14) | 43,449 | - | - | - | 43,449 |
| Financial assets held for trading | | | | | |
| Financial derivatives | 4,320 | 7,284 | 1,902 | - | 13,506 |
| Other than financial derivatives | 190 | 2,655 | 1,323 | - | 4,168 |
| Financial assets held for trading pledged as collateral | - | 196 | 1,901 | - | 2,097 |
| Financial assets designated at fair value through profit or loss | 29 | 483 | 2,864 | - | 3,376 |
| Available-for-sale financial assets | 629 | 15,449 | 32,245 | 454 | 48,777 |
| Available-for-sale financial assets pledged as collateral | 41 | 891 | 4,915 | - | 5,847 |
| Loans and receivables | 608,053 | 214,739 | 151,221 | - | 974,013 |
| Fair value adjustments of the hedged items in portfolio hedge | (1,173) | (2,600) | 290 | - | (3,483) |
| Held-to-maturity investments | 11,185 | 42,795 | 32,624 | - | 86,604 |
| Held-to-maturity investments pledged as collateral | 4,394 | 19,994 | 4,629 | - | 29,017 |
| Derivatives used for hedging | 2,406 | 5,511 | 531 | - | 8,448 |
| Other assets (Note: 23) | 657 | - | - | - | 657 |
| **Total carrying value** | **674,180** | **307,397** | **234,445** | **454** | **1,216,476** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 6,199 | 8,015 | 1,718 | - | 15,932 |
| Other than financial derivatives | 15,331 | 5,224 | 173 | - | 20,728 |
| Financial liabilities designated at fair value through profit or loss | 13 | 7,547 | 1,938 | - | 9,498 |
| Financial liabilities at amortised cost | 475,140 | 320,106 | 350,642 | | 1,145,888 |
| Fair value adjustments of the hedged items in portfolio hedge | (262) | (1,473) | (2,068) | - | (3,803) |
| Derivatives used for hedging | 1,975 | 5,188 | 3,310 | - | 10,473 |
| Other liabilities (Note: 26) | 3,267 | - | - | - | 3,267 |
| **Total carrying value** | **501,663** | **344,607** | **355,713** | **-** | **1,201,983** |

SEPARATE FINANCIAL STATEMENTS

The following table sets out the financial assets and liabilities of the Bank by expected remaining maturity as at 31 December 2016:

| (CZKm) | Less than 1 year | 1 year to 5 years | More than 5 years | Without maturity | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with Central banks and other demand deposits (Note: 14) | 47,647 | - | - | - | 47,647 |
| Financial assets held for trading | | | | | |
| Financial derivatives | 3,568 | 6,967 | 2,483 | - | 13,018 |
| Other than financial derivatives | 1,063 | 3,200 | 3,867 | - | 8,130 |
| Financial assets held for trading pledged as collateral | 1 | - | 567 | - | 568 |
| Financial assets designated at fair value through profit or loss | 28 | - | 3,457 | - | 3,485 |
| Available-for-sale financial assets | 21,875 | 11,965 | 35,807 | 342 | 69,989 |
| Available-for-sale financial assets pledged as collateral | 16 | 1,002 | 2,060 | - | 3,078 |
| Loans and receivables | 352,250 | 200,430 | 145,259 | - | 697,939 |
| Fair value adjustments of the hedged items in portfolio hedge | 563 | 234 | - | - | 797 |
| Held-to-maturity investments | 13,355 | 56,743 | 46,528 | - | 116,626 |
| Held-to-maturity investments pledged as collateral | 5,288 | 7,909 | 2,856 | | 16,053 |
| Derivatives used for hedging | 2,727 | 6,922 | 1,974 | - | 11,623 |
| Other assets (Note: 23) | 792 | - | - | - | 792 |
| **Total carrying value** | **449,173** | **295,372** | **244,858** | **342** | **989,745** |
| **LIABILITIES** | | | | | |
| Financial liabilities held for trading | | | | | |
| Financial derivatives | 3,363 | 6,879 | 2,204 | - | 12,446 |
| Other than financial derivatives | 18,588 | 6,720 | 2,314 | - | 27,622 |
| Financial liabilities designated at fair value through profit or loss | 57 | 1,248 | 315 | - | 1,620 |
| Financial liabilities at amortised cost | 311,866 | 282,237 | 315,531 | - | 909,634 |
| Fair value adjustments of the hedged items in portfolio hedge | 545 | 2,938 | 1,313 | - | 4,796 |
| Derivatives used for hedging | 2,728 | 5,541 | 2,149 | - | 10,418 |
| Other liabilities (Note: 26) | 3,814 | - | - | - | 3,814 |
| **Total carrying value** | **340,961** | **305,563** | **323,826** | **-** | **970,350** |

## 33. CONTINGENT ASSETS, LIABILITIES AND COMMITMENTS

### Contingent assets

Based on a court ruling, the Bank recovered a written-off loan amounting to CZK 485 m in 2007. Due to the uncertainty regarding the continuing court proceedings, following the appeal by the counterparty against the decision, the Bank will not recognise this amount in the statement of income until the final court decision regarding the Bank's claim. In 2011, the original court ruling was cancelled and the legal case was passed to the court in the first instance for new judicial proceedings. Based on that decision, the Bank returned the expenses compensation of CZK 3 m from the total received amount from the original court case to the counterparty. Judicial proceeding is continuing at the Supreme court.

### Contingent liabilities and commitments

The contingent liabilities and commitments at 31 December 2017 and 2016 are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Loan commitments - irrevocable (Note: 38.2) | 98,640 | 95,191 |
| Loan commitments - revocable | 56,365 | 48,225 |
| Financial guarantees (Note: 38.2) | 34,555 | 32,243 |
| Other commitments (Note: 38.2) | 1,340 | 1,324 |
| | **190,900** | **176,983** |
| Provisions for loan commitments and guarantees (Notes: 27, 38.2) | 466 | 232 |

Revocable loan commitments are such commitments in which the Bank may at any time limit the amount that may be drawn under the credit limit. Further the Bank may not provide any drawdown under the credit facility requested by the client or the Bank can suspend further drawdowns under the credit facility all together. The Bank can do so with or without specifying the reason, giving a prior notice or stipulating any time limit. Loan commitments which do not meet the above definition are assessed as irrevocable.

The contractual amounts described above represent the maximum credit risk that would arise if the contracts were fully drawn, the customers defaulted and the value of any existing collateral became worthless. Many of the commitments are collateralised and most are expected to expire without being drawn upon; therefore, the total commitment contractual amounts do not necessarily represent the risk of loss or future cash requirements (Note: 38.3).

### Litigation

Other than the litigations, for which provisions have already been made (Note: 27), the Bank is named in and is defending a number of legal actions in various jurisdictions arising in the ordinary course of business. The Bank does not believe that the ultimate resolution of these legal actions will result in a material impact on the financial position of the Bank.

The Bank is subject to a number of claims in the context of the IPB acquisition amounting to tens of billions of Czech Crowns. The Bank believes that such claims are unfounded. In addition, the Bank believes that potential risk arising from such claims is covered by guarantee agreements issued by the institutions of the Czech state.

Further, the Bank has initiated a number of legal actions to protect its assets.

### Taxation

Czech tax legislation, interpretation and guidance are still evolving. Consequently, under the current taxation environment, it is difficult to predict the interpretations that the respective tax authorities may apply in a number of areas. As a result, the Bank has used its current understanding of the tax legislation in the design of its planning and accounting policies. The effect of the uncertainty cannot be quantified.

### Operating lease commitments (Bank is the lessee)

Future minimum lease payments under operating leases related to information technologies, land and buildings are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Not later than 1 year | 457 | 670 |
| Later than 1 year and not later than 5 years | 912 | 1,626 |
| Later than 5 years | 190 | 195 |
| | **1,559** | **2,491** |

Future minimum sublease payments amounted to CZK 14 m as at 31 December 2017 (31 December 2016: CZK 56 m).

The operating leases related to land and buildings can be technically cancelled under the Czech law; however, the Bank is commercially bound to continue with these leases for the periods set out above.

**Operating lease receivables (Bank is the lessor)**

Future minimum lease payments (including sublease payments) under operating leases related to land and buildings are as follows:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Not later than 1 year | 14 | 26 |
| Later than 1 year and not later than 5 years | 5 | 14 |
| | **19** | **40** |

These operating leases can be technically cancelled under Czech law; however, the lessees are commercially bound to continue with these leases for the periods set out above.

**Other contingent liabilities – construction of new headquarter building**

The Bank committed to its subsidiary Radlice Rozvojová and to the developer to finance the development of a new headquarter building in the amount of CZK 1,847 m as at 31 December 2017 (31 December 2016: 1,832 m).

## 34. REPURCHASE AGREEMENTS AND COLLATERAL

The following table shows an analysis of the loans the Bank has made to counterparties in reverse repurchase agreements according to the lines of the statement of financial position in which they are included:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| **Financial assets** | | |
| Loans and receivables | 475,072 | 235,046 |
| | **475,072** | **235,046** |

Under reverse repurchase agreements, the Bank obtains legal ownership of the respective collateral received and, thus, is permitted to use the collateral; however, the same collateral must be delivered back to the borrower of the funds on maturity.

The fair value of financial assets accepted as collateral in connection with reverse repo transactions and securities lending as at 31 December 2017 was CZK 492,763 m, of which CZK 30,703 m has been either sold or repledged (31 December 2016: CZK 236,345 m and CZK 16,596 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) | 2017 | 2016 |
|---|---|---|
| **Financial liabilities** | | |
| Financial liabilities held for trading | 2,097 | - |
| Financial liabilities at amortised cost | 22,011 | 9,452 |
| | **24,108** | **9,452** |

The Bank contracts repo operations under the standard conditions currently applied on the market. Amounts of financial assets pledged as collateral in repo transactions and securities lending are described in Financial assets at fair value through profit or loss (Note: 15) and Financial investments (Note: 16).

## 35. OFFSET FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The following table shows an analysis of the financial assets and liabilities of the Bank that have not been set-off as at 31 December 2017:

| (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 | 18,483 | - | 18,483 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 3,471 | - | 3,471 |
| **Total trading and hedging derivatives** | **21,954** | **-** | **21,954** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 475,072 | - | 475,072 |
| **Total repurchase agreements (Note: 34)** | **475,072** | **-** | **475,072** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,392 | - | 18,392 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 8,013 | - | 8,013 |
| **Total trading and hedging derivatives** | **26,405** | **-** | **26,405** |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 24,108 | - | 24,108 |
| **Total repurchase agreements (Note: 34)** | **24,108** | **-** | **24,108** |

The following table shows an analysis of the financial assets and liabilities of the Bank that have not been set-off as at 31 December 2016:

| (CZKm) | Gross amounts of recognised financial instrument | Gross amounts of recognised financial instrument set off | Net amounts of financial instrument presented in the balance sheet |
|---|---|---|---|
| **FINANCIAL ASSETS** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 19,087 | - | 19,087 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 5,554 | - | 5,554 |
| **Total trading and hedging derivatives** | **24,641** | **-** | **24,641** |
| Repurchase agreements not set-off that are not subject to an enforceable master netting arrangement | 235,046 | - | 235,046 |
| **Total repurchase agreements (Note: 34)** | **235,046** | **-** | **235,046** |
| Other financial assets not set-off that are not subject to an enforceable master netting arrangement | 792 | - | 792 |
| **Total other financial assets (Note: 23)** | **792** | **-** | **792** |
| **FINANCIAL LIABILITIES** | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 20,647 | - | 20,647 |
| Derivatives not set-off that are not subject to an enforceable master netting arrangement | 2,217 | - | 2,217 |
| **Total trading and hedging derivatives** | **22,864** | **-** | **22,864** |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 9,452 | - | 9,452 |
| **Total repurchase agreements (Note: 34)** | **9,452** | **-** | **9,452** |
| Other financial liabilities not set-off that are not subject to an enforceable master netting arrangement | 3,814 | - | 3,814 |
| **Total other financial liabilities (Note: 26)** | **3,814** | **-** | **3,814** |

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 2017:

| (CZKm) | Net amounts of financial assets and liabilities presented in the balance sheet | Amounts not set off in the balance sheet: Financial instruments | Cash collateral | Securities collateral | Total net amount |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,483 | 16,502 | 1,651 | - | 330 |
| Debt securities pledged as collateral in repo transaction not set-off that are subject to an enforceable master netting arrangements | 24,108 | 24,108 | - | - | - |
| **Total carrying value** | **42,591** | **40,610** | **1,651** | **-** | **330** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 18,392 | 16,502 | 1,643 | - | 247 |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 24,108 | - | - | 24,108 | - |
| **Total carrying value** | **42,500** | **16,502** | **1,643** | **24,108** | **247** |

The following table shows an analysis of the financial assets and liabilities of the Bank that have not been set-off and are subject to an enforceable master netting arrangement or similar agreement as at 31 December 2016:

| (CZKm) | Net amounts of financial assets and liabilities presented in the balance sheet | Amounts not set off in the balance sheet: Financial instruments | Cash collateral | Securities collateral | Total net amount |
|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 19,087 | 17,747 | 1,054 | - | 286 |
| Debt securities pledged as collateral in repo transaction not set-off that are subject to an enforceable master netting arrangements | 9,452 | 9,452 | - | - | - |
| **Total carrying value** | **28,539** | **27,199** | **1,054** | **-** | **286** |
| **FINANCIAL LIABILITIES** | | | | | |
| Derivatives not set-off that are subject to an enforceable master netting arrangement | 20,647 | 17,747 | 2,699 | - | 201 |
| Repurchase agreements not set-off that are subject to an enforceable master netting arrangement | 9,452 | - | - | 9,452 | - |
| **Total carrying value** | **30,099** | **17,747** | **2,699** | **9,452** | **201** |

The amounts in both tables are subject to master netting agreement in accordance with International Swaps and Derivatives Association (ISDA), however with no intention to settle them on a net basis.

## 36. RELATED PARTY DISCLOSURES

A number of transactions are executed with related parties in the normal course of business.

The outstanding balances of assets from related party transactions as at 31 December 2017 are as follows:

| (CZKm) | Cash, balances with central banks and other demand deposits | Financial assets held for trading | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets | Loans and receivables | Derivatives used for hedging | Other assets |
|---|---|---|---|---|---|---|---|
| Directors / Top management | - | - | - | - | - | - | - |
| KBC Bank NV | 550 | 3,952 | - | - | 1,434 | 6,235 | - |
| Entities under common control | | | | | | | |
| ČSOB SK | 44 | 8 | - | - | - | - | - |
| Other | 23 | 19 | - | - | 123 | - | 2 |
| Subsidiaries | | | | | | | |
| BANIT | - | - | - | - | 135 | - | - |
| ČSOB Factoring | - | - | - | - | 2,677 | - | - |
| ČSOB Leasing | - | 16 | - | - | 26,482 | - | - |
| Hypoteční banka | 2 | 501 | 3,396 | 19,332 | 208,963 | 296 | 18 |
| Patria Finance | - | - | - | - | 97 | - | - |
| Associates | | | | | | | |
| ČSOB AM | - | - | - | - | 144 | - | - |
| ČSOB Pojišťovna | - | 145 | - | - | - | - | 7 |
| Joint ventures | | | | | | | |
| ČMSS | - | - | - | - | 40 | 20 | - |

The outstanding balances of liabilities from related party transactions as at 31 December 2017 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Top management | - | 212 | - | 48 |
| KBC Bank NV | 2,262 | 341,444 | 9,311 | 3 |
| Entities under common control | | | | |
| ČSOB SK | 2,098 | 43 | - | - |
| Other | 2 | 93 | - | 54 |
| Subsidiaries | | | | |
| BANIT | - | - | - | 41 |
| ČSOB Advisory | - | 24 | - | - |
| ČSOB Leasing | 181 | 75 | - | - |
| Hypoteční banka | 1,873 | 6,621 | - | - |
| Patria Corporate Finance | - | 14 | - | - |
| Patria Finance | - | 31 | - | - |
| Radlice Rozvojová | - | 15 | - | - |
| Associates | | | | |
| ČSOB AM | - | 85 | - | - |
| ČSOB Pojišťovna | 43 | 1,119 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 3,616 | 8 | - |

The outstanding balances of assets from related party transactions as at 31 December 2016 are as follows:

| (CZKm) | Cash, balances with central banks and other demand deposits | Financial assets held for trading | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets | Loans and receivables | Derivatives used for hedging | Other assets |
|---|---|---|---|---|---|---|---|
| Directors / Top management | - | - | - | - | - | - | - |
| KBC Bank NV | 153 | 2,928 | - | - | 1,158 | 7,867 | - |
| Entities under common control | | | | | | | |
| ČSOB SK | - | 1 | - | - | 36 | - | 15 |
| KBC Investments Limited | - | 211 | - | - | - | - | - |
| Other | - | 33 | - | - | 136 | - | - |
| Subsidiaries | | | | | | | |
| BANIT | - | - | - | - | 126 | - | - |
| Centrum Radlická (merged with ČSOB in 2017) | - | - | - | - | 1,648 | - | - |
| ČSOB Factoring | - | - | - | - | 2,336 | - | - |
| ČSOB Leasing | - | 69 | - | - | 24,068 | - | - |
| Hypoteční banka | 2 | 1,822 | 3,512 | 16,244 | 183,082 | 6 | - |
| Patria Finance (formerly member of Patria group) | - | - | - | - | 159 | - | - |
| Associates | | | | | | | |
| ČSOB AM | - | - | - | - | 130 | - | - |
| ČSOB Pojišťovna | - | 396 | - | - | - | - | 8 |
| Joint ventures | | | | | | | |
| ČMSS | - | - | - | - | 40 | - | - |

The outstanding balances of liabilities from related party transactions as at 31 December 2016 are as follows:

| (CZKm) | Financial liabilities held for trading | Financial liabilities at amortised cost | Derivatives used for hedging | Other liabilities |
|---|---|---|---|---|
| Directors / Top management | - | 96 | - | 57 |
| KBC Bank NV | 3,328 | 200,705 | 8,507 | - |
| Entities under common control | | | | |
| ČSOB SK | 4 | 42 | - | - |
| KBC Investmenten Limited | 35 | 182 | - | - |
| Other | 12 | 153 | - | - |
| Subsidiaries | | | | |
| BANIT | - | - | - | 20 |
| Centrum Radlická (merged with ČSOB in 2017) | - | 3 | - | - |
| ČSOB Advisory | - | 432 | - | - |
| ČSOB Leasing | 2 | 72 | - | - |
| ČSOB Property fund | - | 115 | - | - |
| Hypoteční banka | 47 | 6,622 | 21 | - |
| Patria Corporate Finance (formerly member of Patria group) | - | 3 | - | - |
| Patria Finance (formerly member of Patria group) | - | 318 | - | - |
| Patria Online (merged with ČSOB in 2017) | - | 20 | - | - |
| Radlice Rozvojová | - | 10 | - | - |
| Associates | | | | |
| ČSOB AM | - | 594 | - | - |
| ČSOB Pojišťovna | 21 | 1,368 | - | - |
| Joint ventures | | | | |
| ČMSS | - | 6,043 | - | - |

The outstanding balances of financial assets and liabilities held for trading comprise positive and negative fair values of derivative financial instruments (mainly single currency and cross-currency interest rate swaps). Majority of these transactions are collateralised by cash deposit or by securities. Loans and receivables from related parties represent balances on current accounts or, in a specific cases, term loans with fixed maturity granted to subsidiaries of the Bank (CSOB Leasing). Financial assets included in the portfolio held for trading, designated at fair value through profit or loss, available for sale and loans and receivables contracted between ČSOB and Hypoteční banka represent mortgage debenture bonds with the contractual maturities from 3 years up to 30 years issued by Hypoteční banka and purchased by the Bank on a primary capital market. Financial liabilities to related parties measured at amortised cost consist of balances on demand deposits. Liabilities to KBC Bank NV represent balances on money-market products, specifically promissory notes with maturities up to one year issued by the Bank, repo transactions and short-term deposits.

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:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| (CZKm) | Interest income | Interest expense | Interest income | Interest expense |
| Directors / Top management | - | - | - | - |
| KBC Bank NV | 2,248 | 1,147 | 1,106 | 683 |
| Entities under common control | | | | |
| ČSOB SK | - | 3 | 3 | 1 |
| Other | 2 | - | - | - |
| Subsidiaries | | | | |
| BANIT | 2 | - | 2 | - |
| Centrum Radlická (merged with ČSOB in 2017) | - | - | 53 | - |
| ČSOB Factoring | 12 | - | 13 | - |
| ČSOB Advisory | - | 1 | - | 1 |
| ČSOB Leasing | 212 | - | 266 | - |
| Hypoteční banka | 2,551 | 384 | 2,229 | 408 |
| Patria Finance | 4 | - | 2 | - |
| Associates | | | | |
| ČSOB Pojišťovna | - | 20 | - | 20 |
| Joint ventures | | | | |
| ČMSS | 7 | 89 | 1 | 85 |

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

| (CZKm) | 2017 Fee and commission income | 2017 Fee and commission expense | 2016 Fee and commission income | 2016 Fee and commission expense |
|---|---|---|---|---|
| KBC Bank NV | 64 | 2 | 83 | 1 |
| Entities under common control | | | | |
| ČSOB SK | - | - | - | 5 |
| KBC Securities NV | 7 | - | 10 | - |
| Other | - | 1 | - | - |
| Subsidiaries | | | | |
| BANIT | - | 204 | - | 190 |
| ČSOB Factoring | 1 | - | 1 | - |
| ČSOB Leasing | 18 | 1 | 13 | 2 |
| ČSOB Penzijní společnost | 15 | - | 10 | - |
| Hypoteční banka | 280 | 133 | 246 | 127 |
| Patria Finance | 14 | 1 | 8 | - |
| Associates | | | | |
| ČSOB AM | 557 | - | 466 | - |
| ČSOB Pojišťovna | 338 | - | 170 | - |
| Joint ventures | | | | |
| ČMSS | 5 | 3 | 14 | 2 |

Dividend income received from subsidiaries, associates and joint ventures in 2017 amounted to CZK 3,209 m (2016: CZK 4,856 m). Rental expenses paid to subsidiaries, associates and joint ventures in 2017 amounted to CZK 3 m (2016: CZK 189 m).

Effective from 1 July 2009, the Bank concluded a service level agreement on the provision of administration services, such as human resources and accounting services, with KBC Group. In 2017, the Bank received CZK 63 m (2016: CZK 68 m) from the provision of administration services and paid expense of CZK 476 m (2016: CZK 591 m) for IT services, including rental expenses on information technologies.

In 2017, the Bank received income of CZK 675 m (2016: CZK 569 m) from ČSOB SK and ČSOB Pojišťovna arising from providing services and support in the following areas such as: ICT services, electronic banking, cards, payment processing, financial management and risk management.

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

| (CZKm) | 2017 Guarantees received | 2017 Guarantees given | 2016 Guarantees received | 2016 Guarantees given |
|---|---|---|---|---|
| KBC Bank NV | 2,444 | 194 | 2,222 | 194 |
| Entities under common control | | | | |
| ČSOB SK | 2,308 | 23 | 2,343 | 23 |
| Kereskedelmi és Hitelbank Rt. | 219 | 18 | 232 | 23 |
| Merrion Properties | - | - | - | 323 |
| Subsidiaries | | | | |
| ČSOB Leasing | - | 1,677 | - | 1,677 |

The outstanding balances of guarantees received from KBC Bank NV and the entities under common control principally comprise sub-participation arrangements and other compensation commitments.

In 2016, the Bank committed to its subsidiary Radlice Rozvojová and to the developer to finance the development of a new headquarter building in the amount of CZK 1,847 m as at 31 December 2017 (31 December 2016: CZK 1,832 m).

## 37. EVENTS AFTER THE END OF THE REPORTING PERIOD

There were no events after the reporting period.

## 38. RISK MANAGEMENT

### *38.1 Introduction*

Risk is an inherent part of ČSOB's activities, and risk and capital management is critical to the results of operations and financial condition of ČSOB.

The principal risks that ČSOB faces are credit risk, liquidity risk, operational and other non-financial risks, market risk, subdivided into trading (trading portfolio) and non-trading (credit and investment portfolio) risks. ČSOB manages risk and capital through a system of ongoing identification, measurement and monitoring, subject to risk and capital limits and other controls. ČSOB primarily allocates capital to each subsidiary and business unit with the aim of achieving an acceptable balance between risk and return. The Bank's risk and capital management system is based on a risk strategy determined by the ČSOB Board of Directors and is consistent with the KBC Group's risk and business strategy, with a primary focus on the early identification and management of risks and trends. ČSOB maintains and develops its risk and capital management system to meet its ongoing internal risk and capital management needs and to comply with all legal and other regulatory (capital) requirements, including Basel III, and the regulations of the CNB, European Central Bank (ECB), European Banking Authority (EBA) and other relevant bodies.

**Risk and Capital Management Organization**

***Main Principles of Risk and Capital Management Organization***

The Bank's risk and capital management organization is based on the principle of segregating risk origination and acceptance from risk monitoring and control. The risk and capital management and control functions are designed to be exercised independently of the front office functions. Nevertheless, the front office is engaged in risk and capital management and control functions and is responsible in the first instance for risk control in all risk and capital management areas. The aim of risk and capital management at ČSOB is to closely cooperate with the business in achieving an acceptable balance between return and risk, as opposed to focusing solely on minimising risks.

The risk and capital management governance model that was implemented within the ČSOB in 2011 is based on the following general principles:

- the business, including both sales and credit departments, should be responsible in the first instance for risk and capital management, and must systematically take into account risk and capital management considerations into all its decisions;
- risk and capital management, and risk reporting, should be performed consistently within the entire KBC Group, including ČSOB, and management incentives should be linked to risk and capital adjusted measures, and aligned consistently within the entire KBC Group;
- the risk and capital management governance structure should be an independent and vertically integrated structure aimed at ensuring that risk and capital management considerations are properly reflected in the business decisions within ČSOB;
- risk and capital management should closely cooperate with the business with the aim of achieving an acceptable balance between return and risk, as opposed to focusing only on minimising risks;
- the Board of Directors should determine the risk appetite of ČSOB within which the business has the right to take risks and beyond which the Chief risk officer (CRO) can intervene; and
- the risk reporting processes should be uniform and insightful to allow for the adoption of risk and capital management decisions at both strategic and implementation levels.

The principles described above establish a governance structure, within which:

(i) the Board of Directors is responsible for determining the risk appetite of ČSOB, and capital allocation within ČSOB, by establishing measurable risk and capital parameters, which must be followed in all business activities;

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

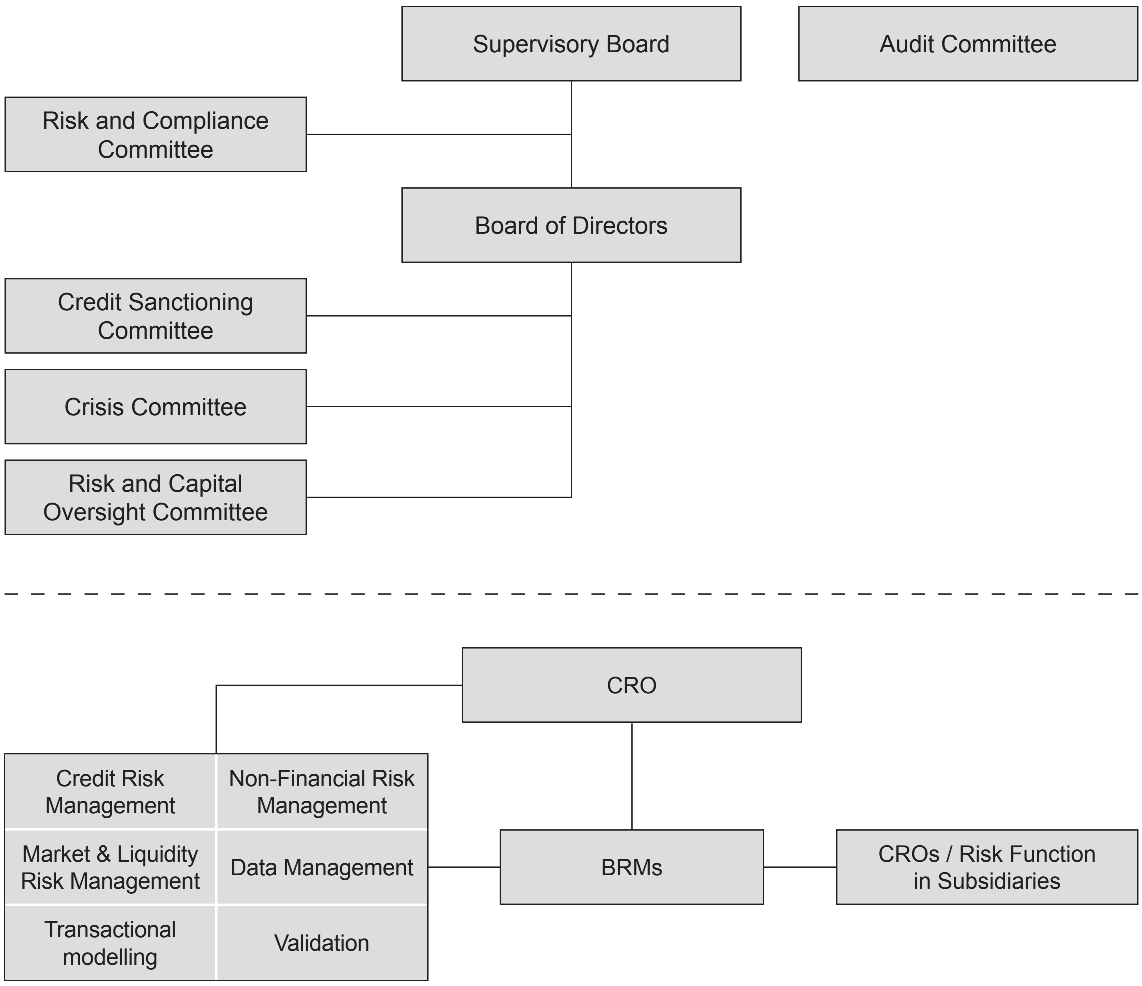
(iii) the CRO, together with the Risk Function, as described below, is responsible for designing the frameworks in which risk management should take place, for translating the risk limits into policies and for ensuring that monitoring systems are in place; and

(iv) the business is responsible for taking risks within the risk and capital allocation.

*Risk and Capital Management Governance*

Risk and capital governance in the Bank is fully embedded in the governance of the KBC Group. During 2015, a few changes were put in place to take account of changes in the organisational structure of ČSOB. Most importantly, the Risk and Compliance Committee was established as a sub-committee of the Supervisory Board with a specific focus on risk management and compliance matters. In 2017, Transactional Modelling was newly incorporated into CRO zone.

The chart below depicts an overview of the principal bodies of the risk and capital governance model in the Bank.




The Bank operates a three-line of defense (LoD) risk management model whereby front office functions, risk management oversight and assurance roles are played by functions independent of one another. The model is characterised primarily by:

- the Board of Directors, assisted by the Audit Committee, Supervisory Board and its Committees,
- the Risk and Capital Oversight Committee,
- an independent Chief Risk Officer, supported by the independent Risk Function, and
- risk-aware business people, who act as the first line of defence ensuring that a risk control environment is established as part of day-to-day operations.

*Supervisory Board*

In its main role, the Supervisory Board oversees whether the governance of the Bank is efficient, comprehensive and adequate, and regularly evaluates the findings obtained from this activity. Its oversight role consists in providing constructive challenge when developing the strategy of the Bank; monitoring of the performance of the management function and the realisation of agreed goals and objectives, business and risk strategies; and ensuring the integrity of the financial information, effective risk management and internal controls (including proper segregation of duties within the Bank).

The Supervisory Board regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

The Supervisory Board:

(i) Oversees whether the system of risk governance is efficient, comprehensive and adequate;

(ii) Regularly discuss matters concerning the risks to which the Bank is or might be exposed;

(iii) Continuously oversees and assures itself of the fulfilment of the risk management strategy and of the operational control's reliability;

(iv) Critically and constructively participates in the evaluation of the management of risks;

(v) Comments on a proposal (of the KBC Group CRO) to entrust as well as dismiss a natural person with the ensuring of the performance of the risk management function, stipulates policies governing remuneration of that person and assesses the activities of the person.

*Risk and Compliance Committee*

The Supervisory Board established the Risk and Compliance Committee which is mainly responsible for advising the Supervisory Board on the Bank's overall current and future risk profile, appetite and strategy, and for overseeing the implementation of that strategy.

The Committee regularly discusses risk management and compliance related matters and communicates with the Bank's risk control function and Chief Risk Officer. In addition, the Risk and Compliance Committee assists the Supervisory Board in the establishment of sound remuneration policies and practices, examines whether incentives provided by the remuneration system take into consideration risk, capital, liquidity likelihood and timing of earnings.

The Committee reviews the activities, structure, independence, professionalism and expertise of Risk management.

The Committee regularly receives integrated risk and capital management reports and information prepared by the Risk Function, as described below.

*Audit Committee*

The Audit Committee, inter alia, monitors the effectiveness of the Bank's internal control, internal audit, risk management systems, establishment of accounting policies by the institution and procedures in preparing the financial statements of the Bank.

With regards to external audit, the Committee oversees the Bank's external auditors, monitors the process of mandatory audits of the financial statements and consolidated financial statements, assesses the independence of statutory auditors and the auditing firm(s), recommends for approval by the management body the appointment, compensation and appointment of the external auditors; review and approves the audit scope and frequency; review audit reports.

In addition to that the Committee checks that the management body in its management function takes necessary corrective actions in a timely manner to address control weaknesses, non-compliance with laws, regulations and policies, and other problems identified by the auditors.

*Board of Directors (BoD)*

The Board of Directors has the overall responsibility for the Bank, proposes its strategic direction within applicable legal and regulatory framework taking into account the institution's long-term financial interests and solvency; ensures the effective implementation of the strategy and is responsible for the day-to-day running of the Bank.

The Board of Directors generally ensures that comprehensive and adequate internal control and risk governance system is established good functioning and efficient, in its entirety and in parts. With regards to the risk management function, the Board of Directors:

(i) Ensures earmarking of adequate and sufficient capacities for management of significant risks, capital and liquidity management, internal models and validations/reviews of such models;

(ii) Approves and regularly evaluates the implementation of:

- Risk Management Charter,
- Risk Appetite of ČSOB,
- Result of Risk Scan,
- Risk Management Strategy,
- Risk Management Framework (including risk specific frameworks),
- Limit Book and Framework,
- Internal Capital Adequacy Assessment Process and Capital Adequacy Policy,
- Recovery and Resolution plan,
- Information Security Strategy;

(iii) Evaluates the overall functioning and efficiency of the internal control and governance system (Internal Control Assessment to ČSOB Supervisory Board), and ensures appropriate steps to rectify the potential identified shortcomings.

On the basis of monthly integrated risk management reports prepared by the Risk Function, the Board of Directors is also responsible for monitoring whether ČSOB's risk profile is in line with ČSOB's risk appetite, limits system and making decisions on risk and capital management issues that may be escalated to its attention by the CRO or the RCOC, as described below.

*Risk and Capital Oversight Committee (RCOC)*

The RCOC assists the Board of Directors in monitoring ČSOB's risk and capital management exposures against the limits set by the Board of Directors. The key responsibilities of the RCOC regarding risk and capital management matters are to:

(i) propose to the Board of Directors the Bank's Risk Appetite;

(ii) propose to the Board of Directors a framework of limits consistent with the Bank's Risk Appetite, within which Risk and Capital will be managed;

(iii) provide an integrated view on Risk exposure against Risk Appetite/Limits and identify/report on 'hidden risks' (including concentration); In the event of Risk exposure being in excess of limit(s), to recommend to the BoD material mitigating actions and decide on non-material mitigating actions to bring Risk exposure back in line;

(iv) periodically review limits and, as necessary, to recommend to the BoD material changes in limit (s) and to decide on non – material limit changes;

(v) monitor market context, solvency, liquidity, risk/return profile, balance sheet profile, maturity transformation and structural interest rate exposure;

(vi) monitor capital adequacy and usage of Regulatory and Economic Capital.

The RCOC reviews regular risk reports prepared by the Risk Function, which are then submitted to the Board of Directors, the Audit Committee and the Supervisory Board. These reports form the basis for the risk monitoring process. Further ad hoc reports may be prepared and submitted, where relevant. The CRO is the chairman and the CFO is the vice-chairman of the Committee.

*Chief Risk Officer (CRO)*

The Chief Risk Officer (CRO), who is a member of the Board of Directors, is in general responsible for the identification, assessment and reporting of risks arising within operations across all business and all risk types, and has a direct management responsibility for the following risk management functions / departments:

(i) Credit Risk Management;

(ii) Market and Liquidity Risk Management;

(iii) Non-financial Risk Management;

(iv) Validations;

(v) Data Management and

(vi) Transactional Modelling.

The CRO:

(i) Ensures that risk management processes are effective and efficient, promotes a culture of risk aware business conduct and prudent risk management;

(ii) Ensures compliance with Group (KBC) and regulatory requirements in the field of risk management;

(iii) Recommends the need for action to address risk & capital issues raised in internal reports;

(iv) Inputs to corrective actions to address local underperformance versus targets and agree to final actions to ensure within risk playing field;

(v) Assess the rate and structure of risk undertaken and the impact thereof on the performance and stability;

(vi) Coordinates the field of continuity management for the business;

(vii) Provides risk and capital reporting to internal (senior management, Board of Directors, Risk and Compliance Committee, Subsidiaries) and external clients (KBC, CNB);

(viii) Presents information concerning the developments in the field of risk management to ČSOB and KBC management;

(ix) Advices on risk related matters to Management Board of subsidiaries within the Group that have a separate legal structure

(x) Is accountable for clear delineation of accountabilities and responsibilities between 3 LoD.

The key strategic and governance responsibilities of the CRO are to:

(i) Recommend Risk Governance structure and roles;

(ii) Decide the structure of the Risk Function;

(iii) Contribute to the Risk Appetite and approves Business line´s Risk Appetites;

(iv) Contribute to the corporate Strategy / strategic plans (including performance targets) development and agree to final Strategy to ensure within risk playing field;

(v) Recommend Risk and Capital Adequacy Policy;

(vi) Contribute to limits and delegation of authority setting within and below BoD delegation and give consent to final decision to ensure within Risk Appetite;

(vii) Contribute to capital and funding allocation and give consent to final allocation to ensure staying within Risk Appetite.

The CRO, in its role has following key execution activities:

(i) Recommend and decide on changes to the Risk Function owned frameworks and policies;

(ii) Decide on validation of transactional models for risk management;

(iii) Input to guidelines for portfolio and transactional model development;

(iv) Input or decide (in line with the delegation rules) on mitigating actions for limit overruns and agree to final decision to ensure staying within Risk Appetite;

(v) Recommend and/or decide ex-post actions to address compliance issues with risk frameworks;

(vi) Ensure the process of assessment and evaluation of the regulatory / internally determined capital adequacy and conduct stress testing;

(vii) Contribute to day to day business decisions as a trusted advisor;

(viii) Agree to risk taking decisions outside of the risk playing field with the right to call "time out".

The CRO may suspend any decisions of any department or committee, or any business unit or sub-unit, affecting the risk or capital position of ČSOB by escalating it to the RCOC or the Board of Directors.

*Risk Function*

The Risk Function provides independent oversight of the management of risks inherent in the Bank's activities. The function is generally responsible for ensuring that effective processes are in place for:

(i) Identifying current and emerging risks;

(ii) Developing risk assessment and measurement systems;

(iii) Establishing policies, practices and other control mechanisms to manage risks;

(iv) Developing risk tolerance limits for Senior Management and Board approval;

(v) Monitoring positions against approved risk tolerance limits; and

(vi) Reporting results of risk monitoring to Senior Management and the Board.

The Risk Function is represented by the following departments reporting to the CRO - Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management, Data Management, Validations and Transactional Modelling. The departments have the following roles:

*Credit Risk Management, Market and Liquidity Risk Management, Non-financial Risk Management*

Particular risk management departments are responsible for managing credit risk, market risk, liquidity risk and operational risk The risk departments have the following roles and responsibilities::

(i) Define the risk management approach and methodology related to their specific risk type, in particular through ownership of the risk type specific framework and policies.

(ii) Define the risk measures that relate to the specific risk types.

(iii) Support ČSOB Group RCOC.

(iv) Support the CROs for all matters that relate to the specific risk types.

(v) Contribute to integrated processes (e.g. ICAAP/ORSA, stress testing).

(vi) Define and deliver the core reports for the specific risk types and deliver inputs for Integrated Risk Report.

(vii) Define and monitor a set of Limits (Primary & Secondary), Targets and indicators (e.g. Early Warning Signals) that cover the specific risk types.

(viii) Follow up on the status of risk and capital management for the specific risks throughout the ČSOB.

***Data Management***

Data Management is responsible for supporting all the other departments forming the Risk Function in data management and reporting. In particular:

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

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

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

Data Management is responsible for risk data governance and also forms the link between the requirements of the Risk Function and ICT.

*Central Credit risk and loss Measurement Validation*

Central Credit risk and loss Measurement Validation focuses on reducing of model risk and seeks a group-wide consistency by providing a well-founded, intelligible and timely independent second opinion and methodological guidance on models for risk measurement and provisioning to their owners, decision bodies and modellers.

*Transactional modelling*

Transactional modelling being part of KBC Group Modelling Competence Centre is responsible for design and review of local credit risk (PD, EAD, LGD), incl. application scorecards, and local provisioning models. The unit further participates in implementation of local and group-wide models into credit decision process of all business segments and for the purpose of regulatory capital calculation.

***Integrated risk management***

Furthermore, specific team within the Risk Function covers overarching aspects of risk management. It‘s mandate is to provide an increased focus on holistic risk management and cross-risk oversight to further enhance our risk management. Key objectives are to:

(i) drive key strategic cross-risk initiatives and establish greater cohesion between defining portfolio strategy and governing execution, including regulatory adherence and recovery planning;

(ii) provide a strategic and forward-looking perspective on the key risk issues for discussion at senior levels within the Bank (risk appetite, stress testing framework);

(iii) strengthen risk culture at the Bank; and

(iv) foster the implementation of consistent risk management standards.

Integrated risk managementis responsible for managing the process of measuring and monitoring risk on an integrated basis within the Bank. In particular, Integrated risk management performs the ICAAP process (see ICAAP Process below), including the management of economic capital, and is responsible for integrated risk reporting (see Risk Monitoring and Reporting below). Integrated risk management also regularly provides reports to the supervisory section of the CNB.

Integrated risk management is also responsible for preparation of recovery plans and cooperates with regulator in preparation of resolution plan.

*Delegation of responsibilities*

The Board of Directors has delegated responsibilities to each of the RCOC and the CRO.

Usage of delegation authority:

- can always be overruled by a higher decision level;
- is always restricted in time:
  - (i) Either for a period explicitly mentioned in the Limit Book & Limit Framework
  - (ii) If no time period is specified, until the next formal limit review
- always needs to be formally recorded ("audit trail") and communicated to Risk Management and CRO.

The RCOC and the CRO may authorize transactions and approve risk limit exceptions described in limit book and limit book framework. The limit book and limit book framework is regularly approved by RCOC and Board of Directors.

Moreover, the CRO may submit to the Board of Directors, the Supervisory Board the Risk and Compliance Committee and/or the Audit Committee issues and concerns related to the entire ČSOB which the CRO considers to have an actual or potential material impact on ČSOB's risk parameters.

***Other Departments and Committees Participating in Risk and Capital Management***

In addition to the Board of Directors, the Audit Committee, the Supervisory Board, the RCOC, the CRO and the Risk Function, the following other departments and committees are involved in day-to-day risk and capital management at the ČSOB level:

*Credit Departments*

The Credit Departments are responsible for implementing and maintaining the individual credit processes within the frameworks designed by the Risk Function and the limits determined by the risk appetite and capital allocation approved by the Board of Directors.

The Credit 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 (ALM Department)*

The ALM Department 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 ALM Department is also primarily responsible for managing the funding and liquidity position of ČSOB. The ALM Department reports to the CFO.

*Internal Audit Department*

The Internal Audit Department regularly audits risk / assesses capital management processes throughout ČSOB examining both the adequacy of its risk and capital management procedures and the Bank's compliance with the same. The Internal Audit Department discusses the results of its assessments with management, and reports its findings and recommendations to the Board of Directors and the Audit Committee. The Internal Audit Department reports to the CEO.

*New and Active Product Processes (NAPPs)*

Members of NAPPs process are responsible for the approval of new products and their distribution and marketing, as well as for the regular review of existing products. Cross functional membership in NAPPs including control functions (the Risk Function, Finance Department, Tax Department, Legal Department and Compliance Department) seeks to ensure that no product may be offered to ČSOB's customers unless all significant risks have been analysed and mitigated and residual risks have been accepted. ČSOB pays special attention to protecting ČSOB against claims arising from the mis-selling of products. As a general rule, all products as well as all distribution channels must be covered by a NAPP.

*Credit Sanctioning Committee (CSC)*

The CSC is a committee with group-wide responsibility and authority to take decisions on individual credit applications falling within the delegated decision powers of the CSC. As such, it acts as the highest decision-making committee for the ČSOB Group with respect to credit risk. The members of the CSC are the CFO, who is the CSC's chairman, and the head of ČSOB credit and bad debts department, corporate advice and underwriting department, corporate and bank credits department, corporate specialised finance department and corporate and institutional banking department. The CSC reports to the Board of Directors.

***Business Risk Meetings (BRMs)***

Business Risk Meetings are established for each business line in the Bank where business specific risk issues are regularly discussed. The CRO has sole decision right within the delegated decision authority which can always be escalated to the Board of Directors at the request of the Board of Directors' member responsible for that area.

***Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP)***

The Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR) require banks to have in place processes to assess and maintain adequate levels of internal capital and liquidity buffers.

The ICAAP is seen as an integral part of the overall management and control system of the Bank, by which ČSOB also adopts and uses reliable, effective and comprehensive strategies and procedures to:

- continually set and assess the need for internal capital; and
- plan and maintain internal capital resources, of the amount, structure and allocation to sufficiently cover the risks that ČSOB is or may be exposed to (internally set and maintained capital adequacy).

As part of the KBC Group, ČSOB has adopted a unified KBC Group ICAAP approach, approved by the top managements of both KBC and ČSOB, taking into account requirements of the home regulator (the Czech National Bank) as well as the host regulator (the European Central Bank).

Regularly, at least once a year, the Board of Directors evaluates the ICAAP, focusing on an overall assessment of whether the strategies and procedures used are reliable, effective, comprehensive and still proportionate to the nature, scale and complexity of the Bank's activities. The Board of Directors also discusses and approves any ICAAP changes and modifications. Moreover, results of Internal Capital Model which is currently used for internal calculation of the ČSOB capital adequacy are quarterly reported to the Board of Directors.

When setting and assessing - on an ongoing basis - its internal capital needs, and planning and maintaining its internal capital resources, ČSOB uses an accounting-value approach, while taking into account quantitative and qualitative inputs and methods, including its own expert analyses, forecasts and scenarios proportionate to the nature, scale and complexity of its activities and the risks associated with them.

ICAAP is forward-looking, i.e. it also takes into account the risks to which the Bank will or may be exposed. Therefore, ČSOB also assesses and takes into account, under the ICAAP the following:

- the processes of planning, preparing and approving new activities, products or systems;
- other ongoing or anticipated material changes in its risk profile or in the external environment;
- effects of possible divergences from the anticipated developments, including the effects of possible extraordinary circumstances; and
- stress test results.

including the methods of reflecting these when planning and securing internal capital resources. The ICAAP strategic planning horizon is three years.

ICAAP and ILAAP address the following material risks to which the Bank is or may be exposed:

- Credit and counterparty risk, (including concentration risk)
- Interest rate in banking book
- Market risk banking book (excl. interest rate)
- Market risk trading book
- Operational risk
- Business and strategic risk
- Funding and liquidity risk

Other risks, are covered, under ICAAP processes, by qualitative measures in risk management, organisation of processes, control mechanisms, etc.

The amount of capital needed is calculated for the ČSOB Group as a separate entity within the KBC Group at the probability level of 99.9% for a one year period, taking into account relevant diversification effects. The internally defined capital resources must fully cover the total capital need and, if compliance with this condition was at risk, ČSOB, in cooperation with the KBC Group, would take relevant remedial measures (increasing capital resources, reducing risk, etc.).

According to the relevant EBA Guidelines the Internal Liquidity Assessment Process (ILAAP) is a process to identify, measure, manage and monitor liquidity, implemented by the bank pursuant to the CRD IV. It discloses all the qualitative and quantitative information about the systems, processes and methodologies to measure and manage liquidity and funding risk, which is necessary to underpin the risk appetite and business strategy both in normal and stressed scenarios.

**Risk measurement and reporting systems**

The Bank's risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment. The Bank also runs worse case scenarios that would arise when extreme events that are unlikely to occur do, in fact, occur.

Monitoring and controlling of risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all businesses is examined and processed in order to analyse, control and identify risks when they arise. This information is presented and explained to the Board of Directors, the RCOC, and the CRO. The reports include aggregate credit exposure, credit metric forecasts, hold limit exceptions, Value at Risk (VaR), interest rate sensitivities, interest rate gaps, liquidity ratios and risk profile changes. Once a quarter, the Supervisory Board receives a comprehensive risk report designed to provide all information necessary to assess and conclude on the risks of the Bank.

A daily report is provided to the top management and all other relevant members of the Bank on the use of market limits and analysis of VaR in the trading book. A weekly report is provided to top management and all other relevant members on interest rate sensitivities and liquidity in the non-trading book.

**Risk mitigation**

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions.

The risk profile is assessed before entering into hedge transactions, which are authorised by the appropriate level of seniority within the Bank. The effectiveness of hedges is assessed by the Middle Office. The effectiveness of all hedge relationships is monitored by the unit quarterly. In situations of ineffectiveness, a new hedge relationship to mitigate risk on a continuous basis is established.

**Excessive risk concentration**

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly. To prevent and manage excessive risk concentration at both a relationship and industry level, the Bank, for selected cases, uses credit risk transfer instruments (e.g. risk sharing participation, risk transfer guarantees, etc).

## *38.2 Credit risk*

Credit risk is the risk of a potential loss expected to arise as a consequence of the non-payment or non-performance by an obligor (a borrower, guarantor, counterparty to a commercial transaction or issuer of a debt instrument), due to that party's insolvency or lack of willingness to pay, or to events or measures taken by the political or monetary authorities of a particular country. The latter is also referred to as country risk.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations. The Bank monitors exposures in relation to these limits. The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties. This includes also regular collateral revisions.

Since September 2012, the Bank is allowed by both Belgian and Czech banking regulators to use the IRB Advanced approach for the capital calculations of its non-retail (Corporate, non-retail SME, Banks, Non-Banking financial institutions) as well as retail exposures. As a result, credit risk is measured, monitored and managed based on the principles of this approach.

For the non-retail exposure (Corporate, non-retail SME, Banks, Non-Banking financial institutions), counterparty risk (i.e. default risk) is managed based on statistical default prediction models that establish a rating (PD / Probability of Default), LGD (Loss Given Default) and EAD (Exposure at Default).

For the retail exposures, statistical models have been developed for PD, LGD and EAD. Contrary to the non-retail exposure, where risk factors are determined on an individual basis, risk factors are determined in Retail based on risk-homogenous sets of exposure (so-called pools).

The model results are used for the capital calculation and for credit decision purposes too.

The default is defined as a situation where at least one of the following conditions is met:

(i) it may be assumed that the customer will not fulfil its obligations in a proper and timely manner without ČSOB seeking to collect its outstanding receivable through credit protection,

(ii) at least one payment of the principal or interest and fees of any obligation of the customer towards ČSOB is more than 90 days past the due date.

At ČSOB, default status is determined to occur any time a forbearance measure-concession is granted: forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. For more, see the section "Forbearance measures".

**Non-retail exposure**

*Rating system: PD (Probability of Default)*

The Bank manages its non-retail credit exposure by establishing counterparty limits that are based on individually assigned internal ratings. These ratings are based on IRB Advanced compliant statistical rating models that take into account financial and non-financial data. The individual PD rating is scaled according to the KBC master scale, which has 12 grades going from PD 1 - the best rating to PD 12, which is the worst.

PD 1 to PD 9 represent the performing exposures.

PD 10 contains: (i) customers where the relevant Bank credit decision authority has judged the exposure to be "unlikely to pay" and none of the obligations are more than 90 days overdue, and (ii) restructured loans. After at least twelve months of performance, the restructured loan may be reclassified to the performing status; and (iii) previously restructured loans already classified as performing less than two years ago which become more than 30 days overdue.

PD 11 represent customers, who have been overdue for 90 days or more, but not subject to bankruptcy proceedings yet.

PD 12 represents customers, which are subject to bankruptcy proceeding or Bank credit decision authority has judged the exposure to be "partly or fully lost" without recourse to credit protection.

PD ratings are used not only for the measurement, monitoring and management of credit risk, but also to determine, among other things, the level at which a credit approval must be obtained, the required collateral and pricing.

The following table sets forth a breakdown of the Bank's risk categories, including the internal and external ratings, for non-retail exposure, and their comparison to the CNB's risk categories:

| | 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 | Collectively assessed | Non-defaulted | Standard |
| Asset Quality review (AQR) | 8-9 | (B-) - C | Performing customers | Collectively assessed | Non-defaulted | Watched |
| Uncertain | 10 | D | Non-performing customers | Individually impaired | Defaulted | Substandard |
| Uncertain | 11 | D | Non-performing customers | Individually impaired | Defaulted | Doubtful |
| Irrecoverable | 12 | D | Non-performing customers | Individually impaired | Defaulted | Loss |

*Individual Credit Processes*

The individual approval, monitoring and work-out processes are subject to risk and capital management frameworks approved by the Group Risk Management (GRM) and/or the CRO but developed, maintained and implemented by the Credit Departments in the Bank. These Credit Departments are also responsible for the implementation of these frameworks in the day-to-day operations of the credit processes and for assuring that individual risk acceptance remains within the limits set by the risk appetite statement.

*Application Process*

The loan or credit application process for non-retail credit exposures involves three steps. Firstly, the employee maintaining the overall relationship with the customer prepares a credit application containing the credit request, the reason for the application and an analysis of the risks (including a financial analysis). Secondly, a credit risk advisor operating independently from the business line, who reports to the Credit Department, provides a written non-binding advice. Thirdly, a decision is taken by the Credit Sanctioning Committee (CSC), the highest local decision taking body, or one of its sub-committees consisting of business line employees and employees in the Credit Department. The Committee adopts its decisions by consensus based on a draft decision formulated by the Chairman or Vice - Chairman.

Within the delegation framework set by the Bank, the Credit Department can delegate the credit decision to the regional manager or senior relationship manager of a branch. Delegations are granted *ad personam*. The delegations are risk based and take into account the total exposure with respect to a customer or customer group.

All credit decisions must be taken according to the "four eyes principle", i.e. at least two persons with appropriate delegation authority need to be involved.

*Individual Monitoring Process*

An individual credit monitoring process is applicable to non-retail exposures (corporate, large non-retail SME). For small non-retail SME an automated behavioural monitoring process is being used. Credit exposures with a rating between PD 1 – 8 (non-retail SME) / PD 1 – 9 (corporate) are reviewed by the business function with the support of monitoring applications. Credit exposures with a rating between PD 9 – 12 (non-retail SME) / PD 10 – 12 (corporate) are reviewed by the Bad Debt Department, which is a sub-department of the Credit Departments.

Regardless of the PD rating, a full credit application must be submitted to the applicable decision authority for a review at least once a year in accordance with the same application process as for the new exposures. Additionally, certain triggers lead to a more frequent review of credit applications. These triggers include breaches of contractual conditions (such as the breach of financial or non-financial covenants or the non-payment of fees, interest or principal), but also events that do not constitute a breach of contract such as a sudden unexpected change in management that could lead to a deterioration of the customer's financial situation.

In addition to the annual review process, commercial real estate finance, acquisition finance and project finance are subject to a quarterly review by the CSC, pursuant to which all major exposure is subjected to a short review of its main credit risk characteristics. Based on the outcome of the general quarterly review, the CSC can take immediate action or request an early full review of the file.

*Collective Monitoring Process*

In addition to the required annual review process, a collective monitoring process is applied to non-retail SME customers. The monitoring of compliance by the customer with covenants specified in the relevant financing documentation is based on information provided by the customer in covenant compliance reports and financial statements. A breach of the internal thresholds and covenants specified in the financing documentation triggers the individual review process as described above.

*Bad Debts Treatment*

For both corporate and non-retail SME customers, the management of bad debts is the sole responsibility of the Bad Debt Department. The credit customer relationship is transferred to the Bad Debt Department when an exposure reaches a PD rating of 9 in the case of non-retail SME and PD rating of 10, in the case of corporate customers.

**Retail exposure (Entrepreneurs, retail SMEs and Individuals)**

*Risk Categories*

The following table sets forth a breakdown of the Bank's risk categories for retail exposure and their comparison to the CNB's risk categories:

| ČSOB risk categories for Retail exposure | | | | ČSOB and CNB risk categories | CNB risk categories |
|---|---|---|---|---|---|
| PD Scale | Days overdue | Performance | Impairment | | |
| Normal | 0 - 30 | Performing | Collectively assessed | Non-defaulted | Standard |
| Asset Quality review (AQR) | 31 - 90 | Performing | Collectively assessed | Non-defaulted | Watched |
| Uncertain | 91 - 180 | Non-performing | Individually impaired | Defaulted | Substandard |
| Uncertain | 181 - 360 | Non-performing | Individually impaired | Defaulted | Doubtful |
| Irrecoverable | 360 and more | Non-performing | Individually impaired | Defaulted | Loss |

In addition, all restructured exposures fall initially within the non-performing category irrespective of whether or not they are overdue. After at least twelve months of performance the restructured exposures may be reclassified to the performing status. Previously restructured exposures already classified as performing less than two years ago, can fall again into non-performing category when becoming more than 30 days overdue.

*Application Process*

The application process in the retail segment is based on the usage of application scorecards for new customers and behavioural scorecards for existing customers. For consumer finance products (personal unsecured loans, retail overdrafts and credit cards) decisions are fully automated based on scorecards in the vast majority of cases. Mortgage decisions are supported by scorecards but decision-taking is essentially manual.

The application process makes extensive use of several external credit bureau databases that include both positive and negative information.

*Monitoring Process*

The monitoring process in the retail segment is performed regularly by the relevant Credit Departments. It is based on aggregated data. It does not involve individual reviews and looks at the development of defaults and probability of default within different sub-portfolios and the development of Credit Cost Ratios within the different sub-portfolios.

*Collection Process*

The collection process in retail consists of two major phases: early collection and late collection. Early collection is generally based on a rapid succession of reminders (via a call centre or automated written notices) starting when any payment is three days overdue and may involve the restructuring of the loan. Late collection starts when any payment is 90 days overdue, and is focused on legal proceedings. All collection units within the Bank are monitored by the Risk Function.

**Derivative financial instruments**

Positive fair values arising from financial derivative instruments entered into by the Bank, such as foreign exchange derivatives and interest rate swaps, give rise to potential future claims resulting from counterparty default and are therefore treated for credit risk purposes in the same way as credit exposures.

### Credit-related commitments risk

The Bank provides guarantees and letters of credit on behalf of its customers, as a result of which the Bank may be required to make payments on such customers' behalf. Such payments are subsequently required to be reimbursed to ČSOB by the customer based on the terms of the underlying credit documentation. These guarantees expose the Bank to similar risks as loans and such risks are managed using the same credit risks control processes and policies.

The following two main commitment risks are treated as off-balance sheet within the Bank:

(i) *Undrawn but Committed Exposure*. This exposure arises when the Bank has a legal commitment to provide a borrower with a facility or credit when asked and such facility or credit has not yet been drawn. This type of exposure comprises to a large extent of short-term exposure, where the Bank's commitment has a duration equal to or shorter than one year.

(ii) *Off-Balance Sheet Products*. This exposure consists of bank guarantees and/or letters of credit. Off-balance sheet products are granted predominantly in the corporate segment and often consist of bid, performance or advance payment bonds for domestic construction companies.

Commitment risks expose the Bank to similar risks as loans and such risks are monitored and managed using the same credit risk control processes and policies.

The Bank manages credit risk in three major portfolios: Credit portfolio, Investment portfolio and Trading portfolio. Besides these there is a credit exposure connected with settlement activities (correspondent banking, settlement of receivables generated within system of electronic toll, which ČSOB administers for the Czech Government – e-Toll), where risk is limited as counterparties are either highly rated banks, government institutions or entities with guarantees by highly rated banks.

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2017. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with central banks and other demand deposits (Note: 14) | - | 42,544 | - | 905 | 43,449 |
| Financial assets held for trading | - | 1,282 | 16,392 | - | 17,674 |
| Financial assets held for trading pledged as collateral | - | - | 2,097 | - | 2,097 |
| Financial assets designated at fair value through profit or loss | - | 3,376 | - | - | 3,376 |
| Available-for-sale financial assets | 562 | 48,215 | - | - | 48,777 |
| Available-for-sale financial assets pledged as collateral | 1,772 | 4,075 | - | - | 5,847 |
| Loans and receivables | 255,439 | 715,832 | - | 2,742 | 974,013 |
| Fair value adjustments of the hedged items in portfolio hedge | - | (3,483) | - | - | (3,483) |
| Held-to-maturity investments | 834 | 85,770 | - | - | 86,604 |
| Held-to-maturity investments pledged as collateral | - | 29,017 | - | - | 29,017 |
| Derivatives used for hedging | - | 8,448 | - | - | 8,448 |
| Other assets (Note: 23) | - | - | - | 657 | 657 |
| Total | 258,607 | 935,076 | 18,489 | 4,304 | 1,216,476 |
| Contingent liabilities (Note: 33) | 33,508 | 1,682 | - | 323 | 35,513 |
| Commitments – irrevocable (Note: 33) | 98,132 | 423 | - | - | 98,555 |
| Total | 131,640 | 2,105 | - | 323 | 134,068 |
| **Total credit risk exposure** | **390,247** | **937,181** | **18,489** | **4,627** | **1,350,544** |

The table below shows the maximum exposure to credit risk for the components of the statement of financial position as at 31 December 2016. The maximum exposure is shown as gross without taking account of any collateral and other credit enhancements.

| (CZKm) | Credits | Investment | Trading | Other assets | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and balances with central banks and other demand deposits (Note: 14) | - | 46,941 | - | 706 | 47,647 |
| Financial assets held for trading | - | 839 | 20,309 | - | 21,148 |
| Financial assets held for trading pledged as collateral | - | - | 568 | - | 568 |
| Financial assets designated at fair value through profit or loss | - | 3,485 | - | - | 3,485 |
| Available-for-sale financial assets | 1,433 | 68,557 | - | - | 69,990 |
| Available-for-sale financial assets pledged as collateral | 1,054 | 2,023 | - | - | 3,077 |
| Loans and receivables | 245,665 | 449,398 | - | 2,876 | 697,939 |
| Fair value adjustments of the hedged items in portfolio hedge | - | 797 | - | - | 797 |
| Held-to-maturity investments | 833 | 115,793 | - | - | 116,626 |
| Held-to-maturity investments pledged as collateral | - | 16,053 | - | - | 16,053 |
| Derivatives used for hedging | - | 11,623 | - | - | 11,623 |
| Other assets (Note: 23) | - | - | - | 792 | 792 |
| Total | 248,985 | 715,509 | 20,877 | 4,374 | 989,745 |
| Contingent liabilities (Note: 33) | 31,329 | 2,006 | - | - | 33,335 |
| Commitments – irrevocable (Note: 33) | 94,110 | 1,081 | - | - | 95,191 |
| Total | 125,439 | 3,087 | - | - | 128,526 |
| **Total credit risk exposure** | **374,424** | **718,596** | **20,877** | **4,374** | **1,118,271** |

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) | 2017 Gross maximum exposure | 2017 Financial effect of collateral | 2017 Net maximum exposure | 2016 Gross maximum exposure | 2016 Financial effect of collateral | 2016 Net maximum exposure |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and balances with central banks and other demand deposits (Note: 14) | 43,449 | - | 43,449 | 47,647 | - | 47,647 |
| Financial assets held for trading | 17,674 | 1,584 | 16,090 | 21,148 | 669 | 20,479 |
| Financial assets held for trading pledged as collateral | 2,097 | - | 2,097 | 568 | - | 568 |
| Financial assets designated at fair value through profit or loss | 3,376 | - | 3,376 | 3,485 | - | 3,485 |
| Available-for-sale financial assets | 48,777 | - | 48,777 | 69,990 | - | 69,990 |
| Available-for-sale financial assets pledged as collateral | 5,847 | - | 5,847 | 3,077 | - | 3,077 |
| Loans and receivables | 974,013 | 579,525 | 394,488 | 697,939 | 341,020 | 356,919 |
| Fair value adjustments of the hedged items in portfolio hedge | (3,483) | - | (3,483) | 797 | - | 797 |
| Held-to-maturity investments | 86,604 | - | 86,604 | 116,626 | - | 116,626 |
| Held-to-maturity investments pledged as collateral | 29,017 | - | 29,017 | 16,053 | - | 16,053 |
| Derivatives used for hedging | 8,448 | 601 | 7,847 | 11,623 | 791 | 10,832 |
| Other assets (Note: 23) | 657 | - | 657 | 792 | - | 792 |
| Total | 1,216,476 | 581,710 | 634,766 | 989,745 | 342,480 | 647,265 |
| Contingent liabilities and commitments – irrevocable (Note: 33) | 134,068 | 35,873 | 98,195 | 128,526 | 34,881 | 93,645 |
| **Total credit risk exposure** | **1,350,544** | **617,583** | **732,961** | **1,118,271** | **377,361** | **740,910** |

Financial effect of collateral represents a fair value of collateral received by the Bank against a credit exposure limited to the outstanding amount of the exposure.

The portfolios are further structured as follows:

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

| 2017 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Corporate | 150,587 | 30,114 | 55,044 | **235,745** | (1,745) | (345) | **233,655** |
| SME | 86,224 | 3,704 | 32,594 | **122,522** | (3,631) | (98) | **118,793** |
| Retail | 28,062 | 3 | 10,573 | **38,638** | (899) | (12) | **37,727** |
| Other | 32 | 70 | 5 | **107** | (23) | (12) | **72** |
| **Total credits** | **264,905** | **33,891** | **98,216** | **397,012** | **(6,298)** | **(467)** | **390,247** |

| 2016 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** | Allowances | Provisions | **Net exposure** |
|---|---|---|---|---|---|---|---|
| Corporate | 149,098 | 27,668 | 54,296 | **231,062** | (1,851) | (85) | **229,126** |
| SME | 82,271 | 3,418 | 29,984 | **115,673** | (3,674) | (118) | **111,881** |
| Retail | 24,183 | 16 | 9,635 | **33,834** | (1,043) | (17) | **32,774** |
| Other | 28 | 459 | 195 | **682** | (27) | (12) | **643** |
| **Total credits** | **255,580** | **31,561** | **94,110** | **381,251** | **(6,595)** | **(232)** | **374,424** |

The following tables show a reconciliation of the allowances for impairment losses on loans and receivables for 2016 and 2017 by classes of financial instruments and by individual and collective impairment:

| (CZKm) | Corporate | SME | Retail | Other | Total |
|---|---|---|---|---|---|
| **At 1 January 2016** | **1,960** | **3,804** | **1,183** | **31** | **6,978** |
| Net increase in allowances for credit losses (Note: 11) | 234 | 419 | (93) | (9) | 551 |
| (Write-offs) / recoveries | (342) | (550) | (47) | 5 | (934) |
| Foreign currency translation | (1) | 1 | - | - | - |
| **At 31 December 2016** | **1,851** | **3,674** | **1,043** | **27** | **6,595** |
| Net increase in allowances for credit losses (Note: 11) | (57) | 218 | (138) | (5) | 18 |
| (Write-offs) / recoveries | (22) | (257) | (6) | 1 | (284) |
| Foreign currency translation | (27) | (4) | - | - | (31) |
| **At 31 December 2017** | **1,745** | **3,631** | **899** | **23** | **6,298** |

| (CZKm) | Individual impairment | Collective impairment | Total |
|---|---|---|---|
| **At 1 January 2016** | **6,486** | **492** | **6,978** |
| Net increase in allowances for credit losses (Note: 11) | 375 | 176 | 551 |
| (Write-offs) / recoveries | (934) | - | (934) |
| **At 31 December 2016** | **5,927** | **668** | **6,595** |
| Net increase in allowances for credit losses (Note: 11) | 90 | (72) | 18 |
| (Write-offs) / recoveries | (284) | - | (284) |
| Foreign currency translation | (31) | - | (31) |
| **At 31 December 2017** | **5,702** | **596** | **6,298** |

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 | 2017 Granted exposure (CZKm) | 2017 Percentage of total exposure | 2016 Granted exposure (CZKm) | 2016 Percentage of total exposure |
|---|---|---|---|---|
| Services | 57,022 | 14.4 | 57,807 | 15.2 |
| Distribution | 54,909 | 13.8 | 52,622 | 13.8 |
| Commercial Real Estate | 47,648 | 12.0 | 46,381 | 12.2 |
| Private persons | 35,485 | 8.9 | 30,744 | 8.1 |
| Building and Construction | 34,316 | 8.6 | 34,253 | 9.0 |
| Automotive | 28,936 | 7.3 | 29,238 | 7.7 |
| Oil, Gas and other Fuels | 15,808 | 4.0 | 19,734 | 5.2 |
| Machinery and Heavy Equipment | 15,420 | 3.9 | 15,253 | 4.0 |
| Electricity | 13,837 | 3.5 | 14,762 | 3.9 |
| Metals | 12,102 | 3.1 | 11,728 | 3.1 |
| Authorities | 12,038 | 3.0 | 13,408 | 3.5 |
| Finance and Insurance | 10,932 | 2.8 | 10,409 | 2.7 |
| Chemicals | 8,040 | 2.0 | 7,558 | 2.0 |
| Electrotechnics | 7,536 | 1.9 | 7,120 | 1.9 |
| Food producers | 5,476 | 1.4 | 5,505 | 1.4 |
| Telecommunications | 5,673 | 1.4 | 2,823 | 0.7 |
| Other sectors | 31,834 | 8.0 | 21,906 | 5.6 |
| **Total** | **397,012** | **100.0** | **381,251** | **100.0** |

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

| 2017 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 170,001 | - | - | (2) | **169,999** |
| Equity securities | 511 | - | - | (57) | **454** |
| Loans and receivables within investment portfolio | 712,349 | 1,682 | 423 | - | **714,454** |
| Derivatives used for hedging | 8,448 | - | - | - | **8,448** |
| Derivatives held for trading | 1,282 | - | - | - | **1,282** |
| Cash and balances with central banks and other demand deposits | 42,544 | - | - | - | **42,544** |
| **Total investment** | **935,135** | **1,682** | **423** | **(59)** | **937,181** |

| 2016 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | Cumulative impairment loss | **Granted exposure** |
|---|---|---|---|---|---|
| Debt securities | 205,569 | - | - | - | **205,569** |
| Equity securities | 392 | - | - | (50) | **342** |
| Loans and receivables within investment portfolio | 450,290 | 2,006 | 1,081 | - | **453,377** |
| Derivatives used for hedging | 11,623 | - | - | - | **11,623** |
| Derivatives held for trading | 839 | - | - | - | **839** |
| Cash and balances with central banks and other demand deposits | 46,846 | - | - | - | **46,846** |
| **Total investment** | **715,559** | **2,006** | **1,081** | **(50)** | **718,596** |

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

| Sector | 2017 Granted exposure (CZKm) | 2017 Percentage of total exposure | 2016 Granted exposure (CZKm) | 2016 Percentage of total exposure |
|---|---|---|---|---|
| Central banks | 517,588 | 55.3 | 281,849 | 39.2 |
| General government | 143,846 | 15.3 | 169,095 | 23.5 |
| Credit institutions | 243,664 | 26.0 | 235,750 | 32.8 |
| Corporate | 32,083 | 3.4 | 31,902 | 4.5 |
| **Total investment** | **937,181** | **100,0** | **718,596** | **100.0** |

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

| 2017 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 6,265 | - | - | 6,265 |
| Derivatives held for trading | 12,224 | - | - | 12,224 |
| **Total trading portfolio** | **18,489** | - | - | **18,489** |

| 2016 (CZKm) | Outstanding gross amount | Contingent liabilities gross | Credit commitments gross | **Granted exposure** |
|---|---|---|---|---|
| Debt securities | 8,683 | - | - | 8,683 |
| Loans and advances | 15 | - | - | 15 |
| Derivatives held for trading | 12,179 | - | - | 12,179 |
| **Total trading portfolio** | **20,877** | - | - | **20,877** |

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

| Sector | 2017 Granted exposure (CZKm) | 2017 Percentage of total exposure | 2016 Granted exposure (CZKm) | 2016 Percentage of total exposure |
|---|---|---|---|---|
| General government | 3,144 | 17.0 | 4,527 | 21.7 |
| Credit institutions | 12,848 | 69.5 | 11,776 | 56.4 |
| Corporate | 2,497 | 13.5 | 4,574 | 21.9 |
| **Total trading portfolio** | **18,489** | **100.0** | **20,877** | **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) | 2017 Total risk | 2017 of which General government | 2016 Total risk | 2016 of which General government |
|---|---|---|---|---|
| Czech Republic | 1,277,410 | 136,736 | 1,042,852 | 160,207 |
| Slovak Republic | 13,494 | 7,126 | 15,796 | 8,041 |
| Greece | 1 | - | 1 | - |
| Italy | 2,084 | - | 2,609 | - |
| Spain | 83 | - | 68 | - |
| Belgium | 13,181 | 993 | 14,222 | 1,835 |
| Hungary | 1,087 | - | 594 | - |
| Other Europe | 38,562 | 8,859 | 37,929 | 10,661 |
| Other | 4,642 | - | 4,200 | - |
| **Total** | **1,350,544** | **153,714** | **1,118,271** | **180,744** |

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 | 2017 Granted exposure (CZK m) | 2017 % of total credit portfolio | 2016 Granted exposure (CZK m) | 2016 % of total credit portfolio |
|---|---|---|---|---|
| 1 largest client | 8,048 | 2.0 | 8,411 | 2.2 |
| 10 largest clients | 56,085 | 14.1 | 55,795 | 14.6 |
| 25 largest clients | 95,805 | 24.1 | 95,914 | 25.4 |

The largest exposures to single clients in the investment portfolio as at 31 December 2017 and 31 December 2016 were:

| Client | 2017 Granted exposure (CZK m) | 2017 % of total investment portfolio | 2016 Granted exposure (CZK m) | 2016 % of total investment portfolio |
|---|---|---|---|---|
| CNB | 517,588 | 55.2 | 281,849 | 39.2 |
| Hypoteční banka | 231,989 | 24.8 | 202,846 | 28.2 |
| Czech Ministry of Finance (S&P's rating AA) | 126,872 | 13.5 | 148,558 | 20.7 |

The largest exposures to single clients in the trading portfolio as at 31 December 2017 and 31 December 2016 were:

| Client | 2017 Granted exposure (CZK m) | 2017 % of total trading portfolio | 2016 Granted exposure (CZK m) | 2016 % of total trading portfolio |
|---|---|---|---|---|
| KBC Bank | 3,952 | 21.4 | 2,928 | 14.0 |
| Czech Ministry of Finance (S&P's rating AA) | 3,144 | 17.0 | 4,527 | 21.7 |

Exposures to counter parties by risk rating class in the investment and trading portfolio as at 31 December 2017 and 31 December 2016 were:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| Rating (S&P) | Granted exposure (CZK m) | % of total portfolio | Granted exposure (CZK m) | % of total portfolio |
| ***Investment portfolio*** | | | | |
| AAA up to and including A- | 668,054 | 71.3 | 472,562 | 65.8 |
| BBB+ up to and including BB- | 8,191 | 0.9 | 9,842 | 1.4 |
| Below BB- | - | - | - | - |
| Unrated | 260,936 | 27.8 | 236,193 | 32.8 |
| **Total** | **937,181** | **100.0** | **718,597** | 100.0 |
| ***Trading portfolio*** | | | | |
| AAA up to and including A- | 12,000 | 64.9 | 12,834 | 61.5 |
| BBB+ up to and including BB | 3,533 | 19.1 | 2,203 | 10.5 |
| Below BB- | - | - | - | - |
| Unrated | 2,956 | 16.0 | 5,840 | 28.0 |
| **Total** | **18,489** | **100.0** | **20,877** | **100.0** |

Included in the item unrated, there are loans granted to the ČSOB's subsidiaries Hypoteční banka, ČSOB Leasing and ČSOB Factoring, as well as securities issued by these companies held by the Bank as part of the investment 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, trade receivables and inventory;
- For retail lending, pledges over residential properties are used for mortgage financing.

The Bank continuously monitors the market value of all collateral, monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses and requests additional collateral in accordance with the underlying agreement when necessary. The amount of collateral reported for an individual receivable does not exceed the carrying amount of the receivable.

Within concluding derivatives transaction to hedge counterparty´s risk the Bank uses Master netting agreements and collateralisation annex (i.e. CSA or its equivalents).

**Impairment assessment**

The main considerations for credit impairment assessment include whether any payments of principal or interest are overdue by more than 90 days or there are any known difficulties in the cash flows of counterparties, worsening of their credibility reflected by credit rating downgrades or infringement of the original terms of the contract. The Bank addresses impairment in two areas: specific impairments and impairments incurred but not reported (IBNR).

Specific impairments are applied to individual assets where there is registered objective evidence of default. All defaulted exposure requires an impairment test – when a client becomes defaulted, it is considered to be impaired and thus specific impairment has to be accounted for. IBNR are applied for asset groups that based on statistical evidence contain probably already impaired assets, but have not been yet individually recognised.

*Specific impairment (Individual assessment)*

The Bank determines allowances appropriate for loans with outstanding amounts above a predefined materiality threshold where there is registered objective evidence of default on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of other financial support, liquidation value of collateral, and the timing of the expected cash flows. Impairment losses are evaluated at each reporting date, unless unforeseen circumstances require more careful attention. For insignificant exposures with registered objective evidence of default a portfolio approach for deriving the impairment allowance is applied using statistical methods and models.

*IBNR (Collective assessment)*

Collective allowances are applied for loans and advances where there has not yet been recognised objective evidence of impairment and they reflect impairment that is likely to be present in the group of assets. Collective allowances are assessed based on statistical estimates and evaluated at each reporting period.

Collective allowances are estimated by taking into consideration:

(i) historical losses in the portfolio;

(ii) current economic conditions;

(iii) the approximate delay between the time a loss is likely to have been incurred and the time it will be identified (emergence period).

The local management is responsible for deciding the length of the emergence period. In 2014, the Bank used a uniform emergence period of four months, which was confirmed by the back-testing. In 2015, the emergence period has been extended to 6 – 8 months for some of the segments based on the latest back-testing results and in 2016 further changes have been made for other segments, prolonging the emergence period also to 8 months. The emergence period extension resulted in 2016 and 2015 an increase of the collective impairment provision of CZK 160 m (2015: CZK 155 m). The back-testing methodology was refined in 2016 and 2015 following the updated Bank policy on determining the emergence period and its back-testing. All 2016 emergence periods have been reconfirmed for 2017.

Financial guarantees and letters of credit are assessed and provision made in a similar manner as allowances for loans and other receivables.

### Quality of credit portfolio

The Bank sorts exposures into five categories for the purpose of credit risk management. The table below shows the credit quality by class of asset for loan-related statement of financial position lines (in gross amounts), based on the Bank's credit rating system as at 31 December 2017 and 2016 by individual portfolios:

| **Credit portfolio** | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Collectively assessed assets | | Individually impaired assets | | | Total |
| (CZKm) | Normal | AQR | Uncertain *(Substandard)* | Uncertain *(Doubtful)* | Irrecoverable | |
| Corporate | 143,907 | 4,408 | 908 | - | 1,364 | 150,587 |
| SME | 80,033 | 1,766 | 1,374 | 269 | 2,782 | 86,224 |
| Retail | 26,970 | 153 | 28 | 196 | 715 | 28,062 |
| Other | - | 8 | - | 1 | 23 | 32 |
| **Total** | **250,910** | **6,335** | **2,310** | **466** | **4,884** | **264,905** |

| **Credit portfolio** | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Collectively assessed assets | | Individually impaired assets | | | Total |
| (CZKm) | Normal | AQR | Uncertain *(Substandard)* | Uncertain *(Doubtful)* | Irrecoverable | |
| Corporate | 141,421 | 4,240 | 1,892 | - | 1,545 | 149,098 |
| SME | 75,526 | 2,112 | 1,416 | 338 | 2,879 | 82,271 |
| Retail | 22,994 | 141 | 62 | 201 | 785 | 24,183 |
| Other | 3 | - | - | 1 | 24 | 28 |
| **Total** | **239,944** | **6,493** | **3,370** | **540** | **5,233** | **255,580** |

| Investment portfolio | 2017 | | | |
|---|---|---|---|---|
| | Collectively assessed assets | | Individually impaired assets | Total |
| (CZKm) | Normal | AQR | Irrecoverable | |
| Debt securities | 169,670 | 329 | - | 169,999 |
| Equity securities | 437 | - | 17 | 454 |
| Loans and receivables within investment portfolio | 714,454 | - | - | 714,454 |
| Derivatives used for hedging | 8,448 | - | - | 8,448 |
| Derivative contracts held for trading | 1,282 | - | - | 1,282 |
| Cash and balances with central banks and other demand deposits | 42,544 | - | - | 42,544 |
| **Total** | **936,835** | **329** | **17** | **937,181** |

| Investment portfolio | 2016 | | | |
|---|---|---|---|---|
| | Collectively assessed assets | | Individually impaired assets | Total |
| (CZKm) | Normal | AQR | Irrecoverable | |
| Debt securities | 205,569 | - | - | 205,569 |
| Equity securities | 341 | - | 1 | 342 |
| Loans and receivables within investment portfolio | 453,377 | - | - | 453,377 |
| Derivatives used for hedging | 11,623 | - | - | 11,623 |
| Derivative contracts held for trading | 839 | - | - | 839 |
| Cash and balances with central banks and other demand deposits | 46,846 | - | - | 46,846 |
| **Total** | **718,595** | **-** | **1** | **718,596** |

| Trading portfolio | 2017 | | |
|---|---|---|---|
| | Collectively assessed assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 6,265 | - | 6,265 |
| Derivative contracts held for trading | 12,224 | - | 12,224 |
| **Total** | **18,489** | **-** | **18,489** |

| Trading portfolio | 2016 | | |
|---|---|---|---|
| | Collectively assessed assets | Individually impaired assets | Total |
| (CZKm) | Normal | Irrecoverable | |
| Debt securities | 8,683 | - | 8,683 |
| Loans and advances | 15 | - | 15 |
| Derivative contracts held for trading | 12,179 | - | 12,179 |
| **Total** | **20,877** | **-** | **20,877** |

The table below shows a credit quality analysis of gross exposures of collectively assessed financial assets in the Credit portfolio:

| (CZKm) | 2017 Neither past due nor individually impaired | 2017 Past due (< 30 days) but not individually impaired | 2017 Past due (> 30 days) but not individually impaired | 2016 Neither past due nor individually impaired | 2016 Past due (< 30 days) but not individually impaired | 2016 Past due (> 30 days) but not individually impaired |
|---|---|---|---|---|---|---|
| Corporate | 148,315 | - | - | 145,661 | - | - |
| SME | 80,966 | 769 | 64 | 76,613 | 956 | 69 |
| Retail | 26,393 | 627 | 103 | 22,549 | 504 | 82 |
| Other | 8 | - | - | 3 | - | - |
| **Total** | **255,682** | **1,396** | **167** | **244,826** | **1,460** | **151** |

Collectively assessed assets reported within Neither past due nor individually impaired gross exposures consist of Normal risk category assets based on the Bank's credit ranking system.

There were no past due but not impaired assets in the Investment and Trading portfolios.

Gross amounts of individually impaired financial assets included in the credit portfolio and the related impairment are as follows:

| (CZKm) | 2017 Gross amount | 2017 Impairment | 2016 Gross amount | 2016 Impairment |
|---|---|---|---|---|
| Credit portfolio | | | | |
| Corporate | 2,272 | (1,662) | 3,437 | (1,767) |
| SME | 4,425 | (3,299) | 4,633 | (3,336) |
| Retail | 939 | (718) | 1,048 | (799) |
| Other | 24 | (23) | 25 | (25) |
| **Total** | **7,660** | **(5,702)** | **9,143** | **(5,927)** |

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

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Equity securities | 17 | 1 |

### Forbearance measures

Forbearance measures consist of concessions towards a borrower facing or about to face financial difficulties, which leave the borrower unable to comply with the original terms and conditions of a credit. Contracts for which forbearance measures have been taken and for which the exit criteria are not fulfilled are referred to as "Forborne credits". Such an approach enables the Bank to control and limit potential future losses stemming from troubled credits.

As a result of the update of the Definition of Default made by the Bank, the Bank's definition of default is aligned with the EBA definition of non-performing exposures (PD 10-11-12), meaning that from 2014 they are only to be seen as synonyms. Previously, only PD grades 11 and 12 fell within the "non-performing" exposure category. The same holds for the definition of the individually impaired financial instrument according to IFRS.

The approved changes impacted the business of the Bank in the following way. The minimum period for the default status for the forborne exposures has been extended from 6 to 12 months; following the conservative approach of the local regulator, default status occurs any time a forbearance measure-concession is granted. The minimum period for assignment of the "Forborne tag" is therefore 36 months: this period consists of the 12 months of the default status, and 24 months of what is referred to as the "probation period". In addition, any time more than 30 days past due are observed at an individual receivable during the "probation period", the receivable is re-classified as defaulted and the 36-month period is re-set.

Outstanding gross amounts and gross amounts of forborne exposures included in the credit portfolio and the related impairment and collateral and financial guarantees as at 31 December 2017 and 2016 are as follows:

| | 2017 | | | | |
|---|---|---|---|---|---|
| | | Forborne exposures | | | |
| (CZKm) | Outstanding gross amount | Exposure of collectively and individually assessed assets | Percentage of outstanding gross amount (%) | Individual and collective impairment | Collateral and financial guarantees |
| Corporate | 150,587 | 2,528 | 1.7 | 683 | 1,173 |
| SME | 86,224 | 997 | 1.2 | 637 | 179 |
| Retail | 28,062 | 130 | 0.5 | 61 | 2 |
| Other | 32 | 1 | 2.7 | - | 1 |
| **Total** | **264,905** | **3,656** | **1.4** | **1,381** | **1,355** |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | | Forborne exposures | | | |
| (CZKm) | Outstanding gross amount | Exposure of collectively and individually assessed assets | Percentage of outstanding gross amount (%) | Individual and collective impairment | Collateral and financial guarantees |
| Corporate | 149,098 | 2,713 | 1.8 | 720 | 1,210 |
| SME | 82,271 | 1,168 | 1.4 | 626 | 355 |
| Retail | 24,183 | 226 | 0.9 | 83 | 3 |
| Other | 28 | - | 0.5 | - | - |
| **Total** | **255,580** | **4,107** | **1.6** | **1,429** | **1,568** |

Detail analysis of forborne exposures included in the credit portfolio and the related impairment as at 31 December 2017 and 2016 are as follows:

| (CZKm) | 2017 | | | | |
|---|---|---|---|---|---|
| | Exposure of collectively assessed assets | Of which past due but not individually impaired assets | Exposure of individually impaired assets | Individual impairment | Collective impairment |
| Corporate | 1,693 | - | 835 | 679 | 4 |
| SME | 69 | 12 | 928 | 635 | 2 |
| Retail | 47 | 11 | 83 | 60 | 1 |
| Other | - | - | 1 | - | - |
| **Total** | **1,809** | **23** | **1,847** | **1,374** | **7** |

| (CZKm) | 2016 | | | | |
|---|---|---|---|---|---|
| | Exposure of collectively assessed assets | Of which past due but not individually impaired assets | Exposure of individually impaired assets | Individual impairment | Collective impairment |
| Corporate | 734 | - | 1,979 | 720 | - |
| SME | 141 | 9 | 1,027 | 621 | 5 |
| Retail | 97 | 14 | 129 | 81 | 2 |
| Other | - | - | - | - | - |
| **Total** | **972** | **23** | **3,135** | **1,422** | **7** |

The following table shows a reconciliation of Gross amounts of forborne exposures for 2017 and 2016 by classes of financial instruments:

| (CZKm) | Corporate | SME | Retail | Other | Total |
|---|---|---|---|---|---|
| **At 1 January 2016** | **2,754** | **1,140** | **266** | **3** | **4,163** |
| Loan which have become forborne | 1,847 | 337 | 58 | - | 2,242 |
| Loans which are no longer considered to be forborne | (1,846) | (182) | (61) | (3) | (2,092) |
| Increase of exposure | 49 | 13 | - | - | 62 |
| Decrease of exposure | (91) | (140) | (37) | - | (268) |
| **At 31 December 2016** | **2,713** | **1,168** | **226** | **-** | **4,107** |
| Loan which have become forborne | 12 | 282 | 24 | 1 | 319 |
| Loans which are no longer considered to be forborne | - | (167) | (42) | - | (209) |
| Increase of exposure | 9 | 1 | - | - | 10 |
| Decrease of exposure | (206) | (287) | (78) | - | (571) |
| **At 31 December 2017** | **2,528** | **997** | **130** | **1** | **3,656** |

The following table shows a reconciliation of Impairments of forborne exposures for 2017 and 2016 by classes of financial instruments:

| (CZKm) | Corporate | SME | Retail | Other | Total |
|---|---|---|---|---|---|
| **At 1 January 2016** | **732** | **567** | **98** | **1** | **1,398** |
| Loan which have become forborne | 28 | 144 | 25 | - | 197 |
| Loans which are no longer considered to be forborne | (89) | (73) | (21) | (1) | (184) |
| Increase of exposure | 63 | 92 | 12 | - | 167 |
| Decrease of exposure | (14) | (104) | (31) | - | (149) |
| **At 31 December 2016** | **720** | **626** | **83** | **-** | **1,429** |
| Loan which have become forborne | 12 | 155 | 11 | - | 178 |
| Loans which are no longer considered to be forborne | - | (50) | (2) | - | (52) |
| Increase of exposure | 4 | 63 | 10 | - | 77 |
| Decrease of exposure | (53) | (157) | (41) | - | (251) |
| **At 31 December 2017** | **683** | **637** | **61** | **-** | **1,381** |

## *38.3 Liquidity risk and funding management*

Liquidity risk is the risk that the Bank will not be able to efficiently meet both expected and unexpected current and future cash flows and collateral needs without normal business operations being disrupted. To limit this risk, the Bank pays significant attention to both operational and strategic liquidity management.

### Operational Liquidity Management

The aim of operational liquidity management is to ensure the smooth processing of the Bank's current payment obligations in CZK as well as in other currencies while minimizing associated cost. Operational liquidity is based on cash flow projections with an outlook of up to ten working days for CZK and one day for other currencies.

### Funding Management

The actual development of liquidity might vary from ALM's liquidity prediction. The Bank can address an adverse liquidity development in several ways. Most typically, the Bank would adjust its investment policy, i.e. decrease the percentage of liabilities reinvested in a cash form and use the liquidity from maturing bonds for other purposes. In the event of a more sudden decrease of liquidity, the Bank can borrow via repo operations on the market or use regulatory repo facilities (in the CNB or ECB). The capacity and readiness to withstand adverse liquidity development is regularly reviewed by the means of stress tests.

Starting from October 2015 the Bank reports on Liquidity Coverage Ratio (LCR), which compares available liquidity buffers to expected net cash outflows within the 30 day horizon under gravely stressed conditions.

The LCR during the year 2017 and 2016 was as follows:

| (%) | 2017 | 2016 |
|---|---|---|
| 31 March | 145.9 | 159.9 |
| 30 June | 145.2 | 154.9 |
| 30 September | 146.9 | 162.3 |
| 31 December | 144.8 | 155.1 |

The LCR ratio is regularly monitored and reported to the top management of the Bank.

**Strategic Liquidity Management**

The aim of strategic liquidity management is to provide sufficient funding for the Bank's business activities in the medium- and long-term horizon. For the strategic liquidity management, the Bank uses the net-stable-funding-ratio (NSFR) which is defined as a ratio of available stable funding (numerator) to required stable funding (denominator). The strategy of the Bank is to maintain the value of NSFR well above one. That means the Bank aims to maintain matched funding, i.e. to ensure that long-term assets are funded by stable liabilities (contractually or statistically), while short-term liabilities are used for the funding of assets that are short-term and/or liquid.

The NSFR is monitored on a monthly basis and it is regularly reported to the top management of ČSOB.

The NSFR during the year 2017 and 2016 was as follows:

| (%) | 2017 | 2016 |
|---|---|---|
| 31 March | 137.1 | 140.5 |
| 30 June | 138.0 | 138.3 |
| 30 September | 140.9 | 141.2 |
| 31 December | 139.7 | 142.7 |

In addition to internally defined limits, the Bank must also comply with a regulatory limit on the basis of mandatory minimum reserve 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 (outflows shown as negative; inflows as positive).

The following table sets out the financial liabilities of the Bank by remaining contractual maturity as at 31 December 2017:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading other than financial derivatives | - | (15,423) | (5,463) | (189) | (21,075) |
| Financial liabilities designated at fair value through profit or loss | - | (13) | (8,099) | (2,176) | (10,288) |
| Financial liabilities at amortised cost | (749,754) | (359,687) | (32,110) | (9,951) | (1,151,502) |
| Fair value adjustments of the hedged items in portfolio hedge | 3,803 | - | - | - | 3,803 |
| Other liabilities (Note: 26) | - | (3,267) | - | - | (3,267) |
| **Contractual cash flows excluding derivatives** | **(745,951)** | **(378,390)** | **(45,672)** | **(12,316)** | **(1,182,329)** |
| Net settled derivatives | **-** | **(4,611)** | **(12,232)** | **(5,937)** | **(22,780)** |
| Trading derivatives | - | (2,690) | (6,751) | (2,029) | (11,470) |
| Hedging derivatives | - | (1,921) | (5,481) | (3,908) | (11,310) |
| Gross settled derivatives | - | **(4,007)** | **(2,792)** | **(267)** | **(7,066)** |
| Trading derivatives | - | (3,877) | (2,557) | (267) | (6,701) |
| *Inflows* | - | *232,789* | *79,260* | *6,646* | *318,695* |
| *Outflows* | - | *(236,666)* | *(81,817)* | *(6,913)* | *(325,396)* |
| Hedging derivatives | - | (130) | (235) | - | (365) |
| *Inflows* | - | *2,833* | *7,668* | *555* | *11,056* |
| *Outflows* | - | *(2,963)* | *(7,903)* | *(555)* | *(11,421)* |
| **Contractual cash flows from derivatives** | **-** | **(8,618)** | **(15,024)** | **(6,204)** | **(29,846)** |
| **Contractual cash flows from financial liabilities** | **(745,951)** | **(387,008)** | **(60,696)** | **(18,520)** | **(1,212,175)** |
| Loan commitments – irrevocable (note 33) | (98,640) | - | - | - | (98,640) |
| Loan commitments – revocable (note 33) | (56,365) | - | - | - | (56,365) |
| Financial guarantees (note 33) | (34,555) | - | - | - | (34,555) |
| Other commitments (note 33) | (1,340) | - | - | - | (1,340) |
| **Contractual cash flows from contingent liabilities** | **(190,900)** | **-** | **-** | **-** | **(190,900)** |

The following table sets out the financial liabilities of the Bank by remaining contractual maturity as at 31 December 2016:

| (CZKm) | On demand | Less than 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|
| **Financial liabilities** | | | | | |
| Financial liabilities held for trading other than financial derivatives | - | (18,589) | (6,522) | (2,278) | (27,389) |
| Financial liabilities designated at fair value through profit or loss | - | (57) | (1,212) | (308) | (1,577) |
| Financial liabilities at amortised cost | (657,684) | (227,586) | (16,110) | (8,109) | (909,489) |
| Fair value adjustments of the hedged items in portfolio hedge | (4,796) | - | - | - | (4,796) |
| Other liabilities (Note: 26) | - | (3,814) | - | - | (3,814) |
| **Contractual cash flows excluding derivatives** | **(662,480)** | **(250,046)** | **(23,844)** | **(10,695)** | **(947,065)** |
| Net settled derivatives | **-** | (6,052) | (9,859) | (3,904) | (19,815) |
| Trading derivatives | - | (3,386) | (5,996) | (2,100) | (11,482) |
| Hedging derivatives | - | (2,666) | (3,863) | (1,804) | (8,333) |
| Gross settled derivatives | - | **(257)** | **(2,038)** | **(375)** | **(2,670)** |
| Trading derivatives | - | (195) | (500) | (62) | (757) |
| *Inflows* | - | *68,584* | *43,569* | *21,548* | *133,701* |
| *Outflows* | - | *(68,779)* | *(44,069)* | *(21,610)* | *(134,458)* |
| Hedging derivatives | - | (62) | (1,538) | (313) | (1,913) |
| *Inflows* | - | *340* | *15,471* | *3,915* | *19,726* |
| *Outflows* | - | *(402)* | *(17,009)* | *(4,228)* | *(21,639)* |
| **Contractual cash flows from derivatives** | **-** | **(6,309)** | **(11,897)** | **(4,279)** | **(22,485)** |
| **Contractual cash flows from financial liabilities** | **(662,480)** | **(256,355)** | **(35,741)** | **(14,974)** | **(969,550)** |
| Loan commitments – irrevocable (note 33) | (118,292) | - | - | - | (118,292) |
| Loan commitments – revocable (note 33) | (44,732) | - | - | - | (44,732) |
| Financial guarantees (note 33) | (30,243) | - | - | - | (30,243) |
| Other commitments (note 33) | ( 1,324) | - | - | - | (1,324) |
| **Contractual cash flows from contingent liabilities** | **(197,591)** | **-** | **-** | **-** | **(197,591)** |

The maturity of contingent liabilities and commitments is on demand. This represents the undiscounted cash flows of the Bank's contingent liabilities and commitments on the basis of their earliest possible contractual maturity. Each undrawn loan commitment is included in the time band containing the earliest date it can be drawn down. For issued financial guarantee contracts, the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

The liquidity risk of the Bank is not managed based on the remaining contractual maturities of the financial instruments, as such the Bank's expected cash flows on these instruments vary significantly from this analysis (Note: 32). For example, undrawn loan commitments are not expected to be drawn down immediately.

### 38.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices. The Bank classifies exposures to market risk into either trading or non-trading portfolios. The market risk for the trading portfolio is managed and monitored based on a historic VaR methodology that reflects the interdependency between risk variables. The secondary measure for risk management is Basis Point Value (BPV) sensitivity. Non-trading positions are managed and monitored using BPV sensitivity analysis.

**Market risk – Trading**

The Board of Directors has set limits on the level of risk that may be accepted. The Bank applies a VaR methodology to assess the market risk positions held and to estimate the potential economic loss based upon assumptions for various changes in market conditions. VaR is a method used to measure financial risk by estimating a potential negative change in the market value of a portfolio at a given confidence level and over a specified time horizon. The Bank uses a full linear VaR model for interest rate and foreign exchange rate risk. These calculations are based on historic scenarios derived from a two-year history. The Bank has no net position in FX options, nor any position in equity. A nominal technical limit for reminder products, in particular interest rate options, commodity derivatives and structured bonds. Positions in these products are not allowed to be material as back-to-back approach is required.

Standard VaR calculations are supplemented by a sophisticated system of stress tests. They consist of examples of extreme, but plausible events on the financial markets to test their impact on the market value of positions currently held by the Bank. The Bank analyses scenarios, dependent and independent of the Bank’s position. Also, real historical scenarios are evaluated on a regular basis.

To enhance the system of risk management, the Bank also uses other methods of risk monitoring, such as interest rate sensitivity BPV, and stop-loss limits.

*Objectives and limitations of the VaR methodology*

The Bank uses the historical VaR methodology to measure and monitor interest rate and foreign exchange rate risks in the trading book observing the relevant Basel II standards. The accuracy of estimated results is verified through back-testing.

*VaR assumptions*

When measuring risks, the Bank applies VaR assumptions to estimate potential losses at a 99% confidence level that is not expected to be exceeded if the current market risk positions were to be held unchanged for 10 days. The use of a 99% confidence level means that, within a ten-day horizon, losses exceeding the VaR figure should occur, on average, not more than once every 100 days. The Bank uses historical daily changes in market variables to assess possible changes in the market value of the trading portfolio based on historical data from the past 500 days.

Since VaR is an integral part of the Bank's market risk management, VaR limits have been established for all trading operations and exposures are reviewed daily against the limits by the management.

The VaR model is back tested on a daily basis. Daily VaR (1 day holding period) is compared with theoretic profit or loss from holding previous day position. Daily VaR is also compared with the actual profit or loss made by the trading book.

The Bank holds regulatory approval to use an internal VaR model for the calculation of capital requirements for interest rate and foreign exchange risks.

ČSOB calculate a Stress VaR to fulfil CRR / CRD IV requirements for market risk capital. A one year historic stress period is used for determining of stress scenarios. These in combination with antithetic scenarios for the same periods are used for computation of stress VaR. All other assumptions are identical to the standard VaR measurement.

The tables below show potential gains or (losses) analysed using VaR 10D 99% model in 2017 and 2016:

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2017 | 674 | 4 | 3 | 681 |
| Average during the period | 487 | 5 | (5) | 487 |
| Highest | 793 | 21 | (20) | 794 |
| Lowest | 122 | (2) | 2 | 122 |

| (CZKm) | Interest rate | Foreign exchange | Effect of correlation | Global VaR total |
|---|---|---|---|---|
| 31 December 2016 | 148 | 5 | (4) | 149 |
| Average during the period | 168 | 16 | (15) | 169 |
| Highest | 227 | 52 | (53) | 226 |
| Lowest | 119 | 2 | 1 | 122 |

**Market risk – Investment portfolio**

*Interest rate risk*

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. The Board of Directors has established limits on the BPV sensitivity. The Board of Directors has set secondary limits on interest rate gaps for stipulated periods. Positions are monitored on a weekly basis and hedging strategies are used to ensure positions are maintained within the established limits.

The following tables demonstrate the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Bank's statement of income and equity.

The sensitivity of the statement of income is calculated by revaluing financial assets designated at fair value through profit or loss for the effects of the assumed changes in interest rates. The sensitivity of the statement of income is analysed by the maturity of the asset. The total sensitivity of the statement of income is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The sensitivity of equity is calculated by revaluing Available-for-sale financial assets, including the effect of any associated hedges, and swaps designated as cash-flow hedges, for the effects of the assumed changes in interest rates. The sensitivity of equity is analysed by the maturity of the asset or swap. The total sensitivity of equity is based on the assumption that there are parallel shifts in the yield curve, while the analysis by maturity band displays the sensitivity also to non-parallel changes.

The Bank’s investment portfolio consists of predominantly linear interest rate sensitive products.

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) as at 31 December 2017 due to revaluation of assets and liabilities that are measured at fair value on recurring basis:

| (CZKm) | Change in basis points | Sensitivity of the statement of income<br>Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|---|
| CZK | + 10 | (14.2) | 2.5 | (60.6) | (56.0) | (128.3) |
| EUR | + 10 | (0.1) | 0.2 | (0.4) | (9.8) | (10.1) |
| USD | + 10 | - | (0.1) | (0.9) | - | (1.0) |
| CZK | - 10 | 14.2 | (2.5) | 60.6 | 56.0 | 128.3 |
| EUR | - 10 | 0.1 | (0.2) | 0.4 | 9.8 | 10.1 |
| USD | - 10 | - | 0.1 | 0.9 | - | 1.0 |

| (CZKm) | Change in basis points | Sensitivity of other comprehensive income<br>Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|---|
| CZK | + 10 | 11.8 | 5.3 | (92.6) | (27.3) | (102.8) |
| EUR | + 10 | 0.7 | - | (26.3) | (14.8) | (40.4) |
| USD | + 10 | (0.1) | - | (4.4) | (0.1) | (4.7) |
| CZK | - 10 | (11.8) | (5.3) | 92.6 | 27.3 | 102.8 |
| EUR | - 10 | (0.7) | - | 26.3 | 14.8 | 40.4 |
| USD | - 10 | 0.1 | - | 4.4 | 0.1 | 4.7 |

The table below shows the sensitivity of the statement of income and other comprehensive income (before tax) as at 31 December 2016 due to revaluation of assets and liabilities that are measured at fair value on recurring basis:

| (CZKm) | Change in basis points | Sensitivity of the statement of income<br>Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|---|
| CZK | + 10 | (12.1) | 7.1 | (66.2) | (39.6) | (110.8) |
| EUR | + 10 | 0.7 | 0.5 | (1.8) | (3.7) | (4.3) |
| USD | + 10 | - | - | (2.1) | - | (2.1) |
| CZK | - 10 | 12.1 | (7.1) | 66.2 | 39.6 | 110.8 |
| EUR | - 10 | (0.7) | (0.5) | 1.8 | 3.7 | 4.3 |
| USD | - 10 | - | - | 2.1 | - | 2.1 |

| (CZKm) | Change in basis points | Sensitivity of other comprehensive income<br>Less than 6 months | 6 months to 1 year | 1 year to 5 years | More than 5 years | Total |
|---|---|---|---|---|---|---|
| CZK | + 10 | 1.4 | (11.4) | (145.3) | (88.5) | (243.8) |
| EUR | + 10 | - | 0.3 | 31.9 | (82.0) | (49.8) |
| USD | + 10 | - | (0.2) | (4.4) | (39.5) | (44.1) |
| CZK | - 10 | (1.4) | 11.4 | 145.3 | 88.5 | 243.8 |
| EUR | - 10 | - | (0.3) | (31.9) | 82.0 | 49.8 |
| USD | - 10 | - | 0.2 | 4.4 | 39.5 | 44.1 |

*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 2017 and 2016:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| (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 | 7 | - | - | 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 Bank's investment portfolio.

- If, at the end of the accounting period, a share is quoted at less than 70% of its acquisition value or;
- If, during a period of one year before the end of the accounting period, the share price of a share was permanently lower than its acquisition value;

The share is irrevocably impaired to the closing quotation at end of the accounting period.

The effect on equity (as a result of a change in the fair value of equity instruments included in Available-for-sale financial assets at 31 December 2017) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, is as follows:

| (CZKm) | Change in equity price (%) | Effect on equity |
|---|---|---|
| Visa Inc. quotation | - 10 | (33) |
| | + 10 | 33 |

The effect on equity (as a result of a change in the fair value of equity instruments included in Available-for-sale financial assets at 31 December 2016) due to a reasonably possible change in equity indices (before tax), with all other variables held constant, was as follows:

| (CZKm) | Change in equity price (%) | Effect on equity |
|---|---|---|
| Visa Inc. quotation | - 10 | (29) |
| | + 10 | 29 |

*Prepayment risk*

Prepayment risk is the risk that the Bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

Prepayment risk of the Bank's products is negligible, however, it is regularly monitored and assessed. Convenient tools for prepayment risk limitation are applied in the area of mortgage loans particularly.

### 38.5 Operational risk

The Bank defines operational risk in line with Basel III as the risk of loss resulting from inadequate or failed internal procedures, people and systems, or from external events. Operational risks include legal, compliance and tax risks. The impact of incidents on the Bank's reputation is taken into consideration when assessing the Bank's vulnerability in respect of operational risk incidents.

**Principles of Operational Risk Management**

Operational risk management starts with the identification of operational risks having materialized within the ČSOB, as well as an assessment of the Bank's vulnerability in respect of potential risks that have not materialised yet. Operational risk management focuses primarily on the key risks and the most risky areas for potential losses. The assessment involves ranking the risks and risk events in terms of their severity and anticipated frequency. The assessment is followed by the decision of an accountable manager, i.e. acceptance of risk or its mitigation by implementing appropriate control measures and/or risk transferring to the 3rd parties and/or risk insurance. Risk events that cannot be prevented may be also mitigated by business continuity arrangements.

**Operational Risk Management Governance**

The basic objective is to make operational risk management a natural part of the decision making in business units. Operational risk management governance is promoted by the CRO and the Risk Function. The fundamental platform is Business Risk Meeting where ČSOB subsidiaries and selected business units report to CRO about operational risks.

*Non-financial Risk Management Department (NFRD)*

The NFRD is responsible for reporting in the non-financial risk management area, including operational risk management. This includes coordination, implementation of methodology, assurance of independent control, advisory to business units and training. NFRD covers also business continuity and information security areas. Other risks related to operational risk are coordinated by special units, including the Compliance Unit, Legal Unit and Tax Unit.

*Local Operational Risk Managers (the "LORMs")*

LORMs are first line support for business managers in respect of non-financial risks (also responsible for first-line business continuity and information security agendas). Beside frequent contacts, regular meetings of LORMs are organised by the NFRD every quarter for training and exchange of information.

*Crisis Management*

Apart from the regular operational risk management infrastructure, the Bank has also established a crisis management infrastructure. Major incidents within the Bank are resolved by the Crisis Management Committee with the involvement of the Board of Directors members. Additionally, the Bank has in place a procedure for resolving local incidents. This procedure is used for more explicit and structured situations, i.e. not complex crises.

**Building Blocks of Operational Risk Management**

*Loss Data Collection*

Loss events are registered into a loss database, which contains a full description of cases involving a higher level of loss. The quality of loss data is monitored on a daily basis, and data is reconciled regularly.

*Deep Dive*

The *Deep Dive* (formerly detailed risk scan) aims to identify and quantify operational risks in products, activities, processes and systems. The risks are subsequently either accepted or mitigated via action plans.It consists of workshops organised and facilitated by the LORM, where business representatives and control function representatives discuss operational risks faced in order to reach a consensus on the adequate risk response (risk acceptance or mitigation).

*Process of Change Management*

Besides above mentioned NAPP addressing product changes, Process of Change Management dealing with non-product changes is also used. Each material change must be analysed and identified risks are further managed according to valid rules.

*Risk Scan*

Every year, before the risk appetite statement is defined, the Bank executes a risk scan identifying and assessing its top risks. All material risk types are explicitly considered, but it is not necessary that a top risk is ultimately withheld for every risk type. The Risk Scan is executed and reported based on the KBC Group Risk Scan Guidance.

The prime responsibility for the identification and assessment of the top risks lies with the business. Input for the risk scan can be derived from several sources, including the main risks identified in the Internal Control Statement, audit recommendations, existing claims, economic forecasts and so on. The Risk Function facilitates the process. This may include gathering business input and documenting the conclusions of the risk scan. The business may call upon the Risk Function for assistance with the identification and assessment of the top risks as well. In any case, the Risk Function challenges the assessment details.

The results of the risk scan, as well as the risk response thereto (acceptance, non-acceptance, mitigating actions), can lead to changes to the existing business plans. Furthermore, they are used as input for the definition of risk appetite in the strategic planning process.

*Group Key Controls, Zero Tolerances, Local Risk and Control Assessment (GKC ZT)*

The Group Key Controls and Zero Tolerances are top down basic control objectives used to mitigate key & killer non-financial risks (including risks to reputation) that are inherent to the processes of the business entities. Each GKC contain the key & killer operational risks related to the involved business process.

Besides Group Key Controls and Zero Tolerances, local approach called Local Risk and Control Assessment aims to identify new key risks and controls and/or revise GKC risks and controls to have one local view of risk exposure per process.

*Risk assessment and its approval*

All operational risks must be assessed according to Uniform Risk Scale consisting of 4 levels, where financial limits and also non-financial criteria are taken into account. Risk is then approved by respective managerial level based on its impact.

*Action plans*

Action plans are activities set up by 1 st LoD that mitigate risk. Action plans are reported by LORMs to NFRD on a Q basis. By using risk based approach, NFRD checks selected action plans when they are proposed for closing by $1^{st}$ LoD.

*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. Key risk indicators also underpin overall risk profile which is set on the level of subsidiary and selected business units of Bank.

## 39. CAPITAL

**Capital Adequacy**

Capital adequacy measures the financial strength and stability of an institution. It compares the amount of the capital held by a financial institution to the risk of possible decline in value of assets on its statement of financial position.

Capital adequacy (or solvency) risk is the risk that the capital base of the bank might fall below an acceptable level. In practice, this entails checking solvency against the minimum regulatory and in-house solvency ratios and its active steering.

**Capital targets and structure**

Regarding the capital targets and structure, the Bank fully follows the KBC Group Capital Policy stating that fully owned subsidiaries shall: (i) hold the regulatory minimum capital (all capital in excess of the regulatory minimum must be held at the Group level), and (ii) build up the regulatory capital from equity.

For the purpose of the ICAAP process, available capital of the Pillar II in the Bank coincides with the Common equity Tier 1 capital under Pillar I.

**Managing solvency**

ČSOB reports its solvency calculated on the basis of IFRS balances taking into account all relevant regulatory requirements. Solvency targets based on external regulatory capital requirements were met throughout 2017 and 2016 with adequate buffers above the regulatory minimum standards, underpinning the very strong capital position of the Bank.

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

In accordance with Basel III, Pillar 2 requirements, the Bank has an Internal Capital Adequacy Assessment Process (ICAAP) in place. The ICAAP examines both the current and future capital situation. To assess the latter situation, a four-year forecast is drawn up for required and available capital, both regulatory and economic, according to a basic scenario that takes account of anticipated internal and external growth, and according to various likely alternative scenarios. The Bank uses also other instruments as required by Pillar 2 mainly in the area of capital planning, stress testing and risk strategies.

The Basel III agreement and corresponding European CRD IV Directive and Regulation introduced new, more stringent capital requirements for financial institutions. According to these requirements, the legal minimum tier-1 ratio increased to 6.0% (with a common equity ratio of 4.5%). On top of this, a capital conservation buffer, and an extra charge for systemic risks of banks were applied. In addition, a countercyclical buffer (0.5% of Common Equity Tier 1, to be determined by the national regulatory authority) was introduced in 2017. The Bank incorporated major changes / ratios into the regular management of the risk and capital positions.

The Bank manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital instruments.

For the purpose of the capital management in 2016 and 2017, the Bank asked the CNB for a permission to retain a part of the net profit to the official 2016 and 2017 capital adequacy ratio before the audit procedure and annual meeting decision on dividend pay-out. As a consequence of the approval, the ČSOB Tier 1 capital increased by CZK Nil as at 31 December 2017 and 5,397 m as at 31 December 2016.

The following table shows the capital and CAD ratio calculated under Basel III in 2017 and 2016 for ČSOB:

| (CZKm) | 2017 | 2016 |
|---|---|---|
| Tier 1 capital | 62,116 | 63,583 |
| Tier 2 capital | - | 533 |
| **Total capital** | **62,116** | **64,116** |
| Regulatory capital requirements | 29,496 | 27,318 |
| **Risk weighted assets** | **368,705** | **341,476** |
| Capital adequacy ratio | 16.85% | 18.78% |

# RELATED PARTIES REPORT

## Report of the Board of Directors of Československá obchodní banka, a. s., on Relations between Related Entities

### 1. Controlled Entity

Československá obchodní banka, a.s., with its registered office at Praha 5, Radlická 333/150, Postcode 150 57, identification number 000 01 350, incorporated in the Commercial Register maintained by the Municipal Court in Praha, Section B XXXVI, Entry 46 (hereinafter "ČSOB" or "the Bank").

### 2. Controlling Entity

KBC Bank NV, with its registered office at Havenlaan 2, B-1080 Brussels, Belgium, as the sole shareholder of ČSOB.

All shares of KBC Bank NV are held (directly or indirectly) by the KBC Group NV (legal entity).

### 3. Structure of the relationships between the Controlling Entity and the Controlled Entity, as well as between the Controlled Entity and Entities Controlled by the same Controlling Entity

KBC Bank NV is a bank supervised by the Belgian National Bank. It is a part of the banking-insurance financial group KBC Group. KBC Group is primarily active in the markets in Belgium, the Czech Republic, Slovakia, Bulgaria, Hungary and Ireland. To a limited extent, it also pursues its business in other countries.

The shares in KBC Group NV (legal entity) are publicly traded on the Euronext Exchange in Brussels. No shareholder has an ownership interest of more than 20%.

Annex 1 to this report gives an overview of the ČSOB and KBC group companies, which is also available at www.kbc.com.

## In the period that was monitored, the Bank had relations mainly with the following related entities:

| Company | Business Address | |
|---|---|---|
| Bankovní informační technologie, s.r.o. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| CBC Banque SA | Grand-Place 5, 1000 Brussels | Belgium |
| CBCB – Czech Banking Credit Bureau, a.s. | Na Vítězné pláni 1719/4, 140 00 Praha 4 | Czech Republic |
| Centrum Radlická a.s. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| Českomoravská stavební spořitelna, a.s. | Vinohradská 3218/169, 100 17 Praha 10 | Czech Republic |
| Československá obchodná banka, a. s. | Žižkova 11, 815 63 Bratislava | Slovak Republic |
| ČSOB Advisory, a.s. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| ČSOB Asset Management, a.s., investment company | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| ČSOB Factoring, a.s. | Benešovská 2538/40, 101 00 Praha 10-Vinohrady | Czech Republic |
| ČSOB Leasing, a.s. | Na Pankráci 310/60, 140 00 Praha 4 | Czech Republic |
| ČSOB Leasing, a.s. | Panónska cesta 11, 852 01 Bratislava | Slovak Republic |
| ČSOB Penzijní společnost, a. s., a member of ČSOB Group | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| ČSOB Poisťovňa a.s. | Žižkova 11, 811 02 Bratislava | Slovak Republic |
| ČSOB Pojišťovna, a. s., a member of ČSOB holding | Masarykovo náměstí 1458, 530 02 Pardubice-Zelené předměstí | Czech Republic |
| ČSOB Property fund, a.s. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| ČSOB stavebná sporiteľňa, a.s. | Žižkova 11, 811 02 Bratislava | Slovak Republic |
| Eurincasso, s.r.o. | Benešovská 2538/40, 101 00 Praha 10-Vinohrady | Czech Republic |
| Hypoteční banka, a.s. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| KBC Asset Management NV | Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek) | Belgium |
| KBC Bank NV | Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek) | Belgium |
| KBC Group NV (legal entity) | Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek) | Belgium |
| KBC Group NV Czech Branch, organizational unit | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| KBC Investments Limited | 111 Old Broad Street, London | United Kingdom |
| KBC Securities NV | Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek) | Belgium |
| K & H BANK Zrt. | Lechner Ödön fasor 9, 1095 Budapest | Hungary |
| K & H Biztosító Zrt. | Lechner Ödön fasor 9, 1095 Budapest | Hungary |
| Merrion Properties s.r.o. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| Patria Finance, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |
| Patria Corporate Finance, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |
| Patria investiční společnost, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |
| Patria Online, a.s. | Jungmannova 745/24, 110 00 Praha 1 | Czech Republic |
| První certifikační autorita, a.s. | Podvinný mlýn 2178/6, 190 00 Praha 9 | Czech Republic |
| Radlice Rozvojová, a.s. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |
| SousedeCZ s.r.o. | Radlická 333/150, 150 57 Praha 5 | Czech Republic |

## 4. Role of the Controlled Entity, Measures and Means of Control

The KBC Group NV (legal entity), specifically KBC Bank NV, controls ČSOB through decisions made by the sole shareholder within the competence of the General Meeting according to the Act on Business Corporations.

The controlling entity also exercises its influence through its representatives on the governing bodies of ČSOB, i.e. the Supervisory Board and/or the Board of Directors. First and foremost, this involves cooperation and coordination of activities related to consolidated risk management, auditing and compliance with the prudential rules that apply to banks and other financial institutions, and the legal requirements.

ČSOB is the controlling entity of the most corporations within the ČSOB Group (the Czech part of the multinational KBC Group) and provides these highly specialized companies (factoring, leasing, asset management etc.) with a range of support services (e.g. HR and Personnel, IT, Internal Audit).

ČSOB, as a universal bank with a large network of branches, is also a distribution point for the products offered by these companies. Within the ČSOB Group, ČSOB also ensures that prudential rules are followed on a consolidated basis.

## 5. Review of Activities in the Accounting Period, Induced by the Interest of the Controlling Entity or its Controlled Entities

Unless otherwise stated, no activities were carried out in the accounting period initiated by or in the interest of the controlling entity or its controlled entities that would affect more than 10% of the equity of ČSOB, including transactions in the ordinary course of business.

During the accounting period, ČSOB repeatedly accepted liabilities towards KBC Bank NV, including short-term money market trading deposits and promissory notes, the value of which exceeded 10% of the company's equity. These activities aim at improving the efficiency of the use of the financial assets within the group. The aforementioned commitments arise from current transactions and are subject to comparable terms and conditions (including interest rates and securing) to transactions with third parties and as such they have not been detrimental to the Bank.

ČSOB, in cooperation with ČSOB Leasing, a.s., carries out a programme of issuing of promissory notes with a limit of CZK 10.5 bn. In 2017, the highest exposure volume of ČSOB in this area equalled CZK 8.9 bn. It is a standard banking product that is also provided to unrelated persons under comparable terms and conditions, and the Bank has not incurred any damage or loss as a result of the performance of the contract.

## 6. Review of Mutual Agreements between the Controlled Entity and the Controlling Entity or among the Controlled Entities

During the accounting period, ČSOB had various relations with the controlling entity, as well as other companies controlled by the controlling entity (for the purpose of this Related Parties Report also referred to as "counterparties") based on common business activities.

**The contractual relations took place in the following areas:**

## BANKING SERVICES

### Accounts, Deposit Products, Domestic and International Payments Services, Domestic and International Cash Management

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods to provide services for maintaining various types of accounts, current and term accounts, interbank deposits (including amendments on the early termination [default] of some deposits, along with settling interest and compensation payments), accounts for the deposit of funds intended to acquire or increase a partnership in a company, and to provide the following products and domestic and international payments services, such as Cash Management NightLine, Virtual Cash Pooling and Real One-Way Cash Pooling. During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods in the field of financial market trading. The contracts were concluded under standard business terms and conditions.

### Payment cards

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods to issue, accept and process payment card transactions. The contracts were concluded under standard business terms and conditions.

### Electronic Banking

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods under which it provided the following electronic banking products: ČSOB Phone banking, ČSOB Smartbanking, ČSOB Internet banking, ČSOB Internetbanking 24, ČSOB Businessbanking 24, ČSOB CEB, and ČSOB MultiCash 24. The contracts were concluded under standard business terms and conditions.

### Cheques and Bills of Exchange

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for procuring bills of exchange and their custody, and contracts for securing the bill-of-exchange programme. The contracts were concluded under standard business terms and conditions.

### Credit Products and Guarantees

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods under which it provided the following credit products: overdrafts, commercial loans, revolving loans, specific-purpose credit facilities, subordinated loans, interbank loans (including amendments on the early termination [default] of some loan agreements, along with interest settlements and payment of compensation) and current account overdrafts, and accepted and issued guarantees, confirmed or open letters of credit, and/or bought back claims from letters of credit, and provided guarantees. The counterparties paid contractual fees, remuneration and interest for these services. The contracts were concluded under standard business terms and conditions.

### Investment Services

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for purchasing and selling investment instruments, ISDA contracts, escrow agreements, contracts for settling investment instrument transactions, contracts for administering securities, depository contracts, agreements on the contact bank, and agreements on the authorization of fax instructions for settling and administering securities. The remuneration provided by the counterparties consisted of commissions and contractual fees. The contracts were concluded under standard business terms and conditions.

### Mortgage Bonds and Bonds

During the accounting period, ČSOB concluded or had concluded mandate contracts or mandate contracts for the provision of the issuance of mortgage bonds issued on the domestic market under the bond programme and mandate contracts for the provision of the issuance of bonds, contracts for subscription and the purchase of mortgage bonds/bonds and contracts for the management of the issuance and provision of payments. The counterparties provided contractual rewards for these services. The contracts were concluded under standard business terms and conditions.

### Receivables

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for the management or assignment of claims/receivables. The Bank provided contractual rewards to the counterparties for these services. The contracts were concluded under standard business terms and conditions.

## OTHER RELATIONS

### Insurance Policies

During the accounting period, ČSOB concluded insurance policies or had concluded insurance policies in previous accounting periods. The consideration consisted of insurance and indemnity. The contracts were concluded under standard business terms and conditions.

### Lease and Rent Contracts

During the accounting period, ČSOB concluded contracts or had concluded contracts in previous accounting periods for renting/leasing non-residential areas, parking places and movable assets. The consideration consisted of contractual prices or the lease of certain items, parts thereof or groups of items. The contracts were concluded under standard business terms and conditions.

### Cooperation Agreements – Employee Benefits

During the accounting period, ČSOB concluded cooperation agreements – employee benefits – or had concluded contracts in previous accounting periods. The consideration consisted of providing employee benefits. The contracts were concluded under standard business terms and conditions.

### Cooperation Agreements – Selling Products and Services

During the accounting period, ČSOB concluded cooperation agreements and framework, mandate and commission agent's contracts or had concluded these contracts and agreements in previous accounting periods, particularly concerning cooperation on product sales, product sales agency, sales support and the use of technology for this purpose, consultancy, and opportunity-seeking. The consideration consisted of cooperation, contractual commissions, contractual rewards or the sale of products. The contracts were concluded under standard business terms and conditions.

### Cooperation Agreements – Joint Observance of Tax Obligations (VAT)

On 9 December 2016, ČSOB concluded an agreement with some of the entities controlled by the same controlling entity (Centrum Radlická, ČMSS, ČSOB Advisory, ČSOB AM, ČSOB Penzijní společnost, ČSOB Pojišťovna, Hypoteční banka, Patria Finance, Patria investiční společnost, Patria Online) on cooperation in the joint observance of tax obligations (VAT) on behalf of the group. The agreement remained valid and effective during the accounting period. The consideration consisted of observance of tax obligations. The agreement was entered into under standard business terms and conditions. During the year 2017, some contracts ceased to exist as a result of the merger between ČSOB and Centrum Radlická a.s. and Patria Online, a.s. as described in the Miscellaneous section.

### Agreements in the field of ICT Services

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods on providing ICT services. The consideration consisted of contractual rewards. The contracts were concluded under standard business terms and conditions.

### Agreements on Providing Services – Call Centre

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide call centre services. The consideration consisted of contractual rewards. The contracts were concluded under standard business terms and conditions.

### Agreements on Providing Services – Back Office and Other Related Services

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide back-office services and supporting processes, i.e. risk management cooperation, developing models, management consultancy, central procurement, accounting and tax services and processing foreign payments. The consideration consisted of contractual rewards and consultations. The contracts were concluded under standard business terms and conditions.

### Agreements on Providing Services – Facilities Management

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide management services for facilities, i.e. accounting and asset administration, food vouchers and catering, accommodation, postal services, document archiving, telephone exchange, fleet management and parking administration and transferring or purchasing movable assets. The consideration consisted of contractual rewards. The contracts were concluded under standard business terms and conditions.

### Agreements on Providing Services – Processing Financial Reporting

During the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods to provide the processing of financial reports for external users services, especially for the Czech National Bank. The consideration consisted of contractual rewards. The contracts were concluded under standard business terms and conditions.

### Agreements on Providing Services – advertising, marketing, internal and external communication

During the accounting period, ČSOB concluded agreements in the fields of advertising, marketing and internal and external communication towards clients, e.g. purchasing of media, communication strategies, event marketing, sponsorship and clients' trade name (brand) management. The consideration consisted of contractual rewards. The contracts were concluded under standard business terms and conditions.

### Agreements on Providing Services – other support services

In the accounting period, ČSOB concluded agreements or had concluded agreements in previous accounting periods for cooperation and the provision of services in the fields of internal auditing, compliance, risk management, legal support, project management, administrative support in finances, including accounting, human resources management, including labour relations and the use of the workforce and administrative support. In the accounting period, ČSOB entered into agreements for cooperation and the processing and exchange of information in the field of macroeconomic analyses, scenarios and forecasts. The consideration consisted of services and contractual rewards. ČSOB also entered into agreements for the processing of personal data or information provision, confidentiality agreements, etc. The contracts were concluded under standard business terms and conditions.

## Miscellaneous

### Termination of Patria Online, a.s., and Centrum Radlická, a. s. as a result of the domestic merger

As a result of the domestic merger between Československá obchodní banka, a.s., as the successor to Patria Online, a.s., company ID 618 59 273, with its registered office at Jungmannova 745/24, Prague 1, postal code 110 00, incorporated in the Commercial Register maintained by the Municipal Court in Praha, Section B, Entry 2804, as a company in the process of dissolution, and Centrum Radlická a.s., company ID 267 60 401, with its registered office at Radlická 333/150, Prague 5, postal code 150 57, as a company in the process of dissolution, on 1 December 2017 the companies Patria Online a.s. and Centrum Radlická a.s. ceased to exist and their assets were transferred to Československá obchodní banka, a. s.

On 13 November 2017, Merrion Properties s.r.o. "in liquidation" ceased to exist and was removed from the Commercial Register.

Following the decision of the founder to close down the branch factory Tee Square Limited Branch, organizational unit, as of 31 December 2016, this branch was removed from the Commercial Register on 5 April 2017.

For the purpose of strengthening the equity, agreements on additional charge apart from the registered capital were concluded within the ČSOB Group.

In order to realize the extension of the headquarters of Československá obchodní banka, a.s., contracts were concluded between Československá obchodní banka, a.s. and Radlice Rozvojová, a.s. on the transfer of land and the execution of the construction.

## SHARE IN PROFITS AND OTHER MEASURES

KBC Bank NV, as the sole shareholder, decided on April 27, 2017, within the competence of the General Meeting, to distribute the profit for the fiscal year 2016, in such a way that a share of the profit amounting to CZK 10.147 bn was paid to the sole shareholder.

During the accounting period, ČSOB collected revenue in the form of profit shares from the following companies: BANIT, ČMSS, ČSOB Factoring, Hypoteční banka, ČSOB Advisory, ČSOB Leasing, ČSOB Penzijní společnost, ČSOB Pojišťovna, Patria Online, První certifikační autorita and CBCB.

In addition, ČSOB made a decision within the competence of the sole shareholder/partner of the companies where the Bank is the sole shareholder/partner. The decision concerned the approval of the financial statements, decisions about the settlement of profits and dividends, election of members of the decision bodies and their remuneration, changes in the Articles of Association, appointment of the auditor, an increase/decrease in share capital and changes in the form of shares.

## 7. Assessing the occurrence of the loss incurred by the Controlled Entity

The contractual and other relations between ČSOB and the controlling entity have not caused damage to ČSOB.

## 8. Evaluation of the relationships between the Controlling Entity and the Controlled Entity, as well as between the Controlled Entity and the Entities Controlled by the same Controlling Entity

Joint synergy within the ČSOB financial group or KBC Group brings positive effects in the areas of cost-effectiveness and human resources and it helps set up the processes so that they are in line with corporate strategy. The cooperation also helps limit certain transactional risks, such as the risks associated with the provision of sensitive information and data to third parties.

The Bank primarily provides banking services to companies within the Group, which mainly include loans, overdrafts, interest-bearing deposits, current accounts and other services.

Receivables and payables with KBC Bank and the enterprises under joint control mainly consist of the fair value of derivative financial instruments, debt instruments, repo transactions and deposit notes.

The mutual cooperation of companies within the KBC Group and ČSOB Group and/or other companies that are controlled by ČSOB helps strengthen its common position on the market and enables the extension of the range of financial services provided to clients in the areas of building savings and mortgages, asset management, collective investment, contributory pension schemes, leasing, factoring, distribution of life and non-life insurance and services relating to securities trading on financial markets.

## 9. Accounting period

This report describes the relations for the accounting period from 1 January 2017 to 31 December 2017.

## 10. Conclusion

The Board of Directors of ČSOB hereby declares that this report has been prepared within the statutory time limit and in accordance with Section 82 of the Act on Business Corporations. While compiling the report, the Board of Directors proceeded with due professional diligence and its scope reflects the purpose of the legislation governing the report under the Act on Business Corporations in relation to the ownership structure of ČSOB.

Praha, 28 March 2018

Československá obchodní banka, a. s.

For and on behalf of the Board of Directors

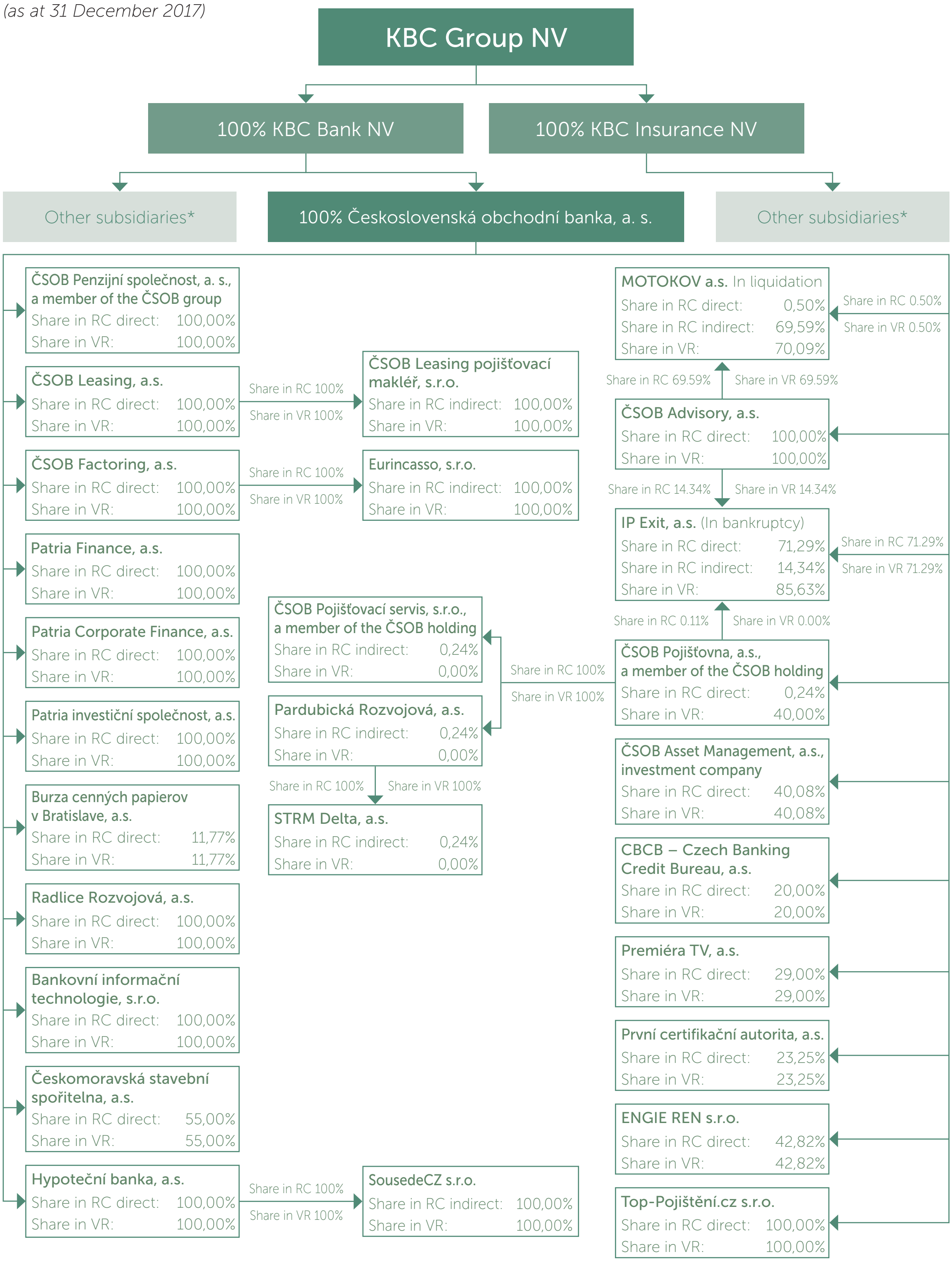
**John Arthur Hollows**
Chairman of the Board of Directors

**Jiří Vévoda**
Member of the Board of Directors

# Appendix to the Related Parties Report

## Overview of companies of the KBC Group and the ČSOB Group

*(as at 31 December 2017)*




*Explanatory notes*

*Percentage shares shown for individual companies are expressed from the ČSOB point of view as a parent company.*
*All shares of KBC Bank and KBC Insurance are held (directly or indirectly) by the KBC Group.*
*ČSOB is 100% owned and fully controlled by KBC Bank.*
** For complete overview of "other subsidiaries" of the KBC Group please refer to KBC's corporate website www.kbc.com, where other details regarding the KBC Group are available.*

*RC: registered capital*
*VR: voting rights*

# ADDITIONAL INFORMATION

## ČSOB Securities

### Shares

### Shares and Share Capital of ČSOB

| | as at 31 December 2017 |
|---|---|
| ISIN | CZ0008000288 |
| Class | Ordinary shares |
| Type | Bearer shares |
| Edition | Book-entered |
| Number of shares | 292,750,002 |
| Nominal value | CZK 20 |
| Total issue volume | CZK 5,855,000,040 |
| **Amount of share capital** | **CZK 5,855,000,040** |
| Paid up in full | 100% |

KBC Bank NV, with its registered address at: Havenlaan 2, B-1080 Brussels (Sint-Jans Molenbeek), Belgium, is the sole shareholder of ČSOB.

**ČSOB shares are not publicly tradable on any official regulated market in either an EU member state, or an EEC member state.**

ČSOB has not issued any convertible bonds or priority bonds as defined by Section 286 of the Act No. 90/2012 Coll., on Commercial Companies and Cooperatives. In 2017, ČSOB neither held any own shares, nor issued stock certificates.

### Rights Attached to ČSOB Shares

Rights and obligations of a shareholder are stipulated by legal regulations, in particular by the Act on Commercial Companies and Cooperatives and the Articles of Association of ČSOB.

**Shareholder rights attached to ČSOB shares include in particular:**

a) The right to obtain a share in the company's profit (dividend) approved by the General Meeting for distribution according to the company's economic results.

b) The right to ask the Board of Directors to convene a Meeting in accordance with legal regulations.

c) The right to attend the General Meeting of Shareholders. At a General Meeting, shareholders have the right to
   1. vote;
   2. request and receive explanation to matters related to the company and controlled persons, should such explanation be necessary to assess a topic discussed by the General Meeting; and
   3. put forward proposals and counter-proposals.

d) The right to obtain a share in the liquidation balance when the company is dissolved trough liquidation.

Voting rights attached to ČSOB shares are unlimited. One share confers one vote.

# ČSOB Securities

## Bonds and Investment Certificates

*(outstanding)*

**Since 2012, ČSOB is an issuer of investment certificates issued under the certificate issuance program (public or non public) in the Czech Republic.**

**By 31 December 2017**, ČSOB recorded the following investment certificate issues in the Czech Republic:

| Issue Name | ISIN | Issue Date | Volume of Investment Certificates Issued (Nominal Value) | |
|---|---|---|---|---|
| ČSOB Investiční certifikát XXIX. (Eurostoxx50) | CZ0000300587 | 15. 4. 2015 | USDm | 5.89 |
| ČSOB Investiční certifikát XXX. (Utility) | CZ0000300579 | 15. 4. 2015 | CZKm | 169.35 |
| ČSOB Investiční certifikát XXXI. (Diskont SX5E) | CZ0000300595 | 22. 4. 2015 | CZKm | 40.23 |
| ČSOB Investiční certifikát XXXV. (2nd worst - Index) | CZ0000300645 | 20. 5. 2015 | CZKm | 90.05 |
| ČSOB Investiční certifikát Unit link I. | CZ0000300652 | 12. 6. 2015 | CZKm | 157.00 |
| ČSOB Investiční certifikát Unit link II. | CZ0000300686 | 10. 7. 2015 | CZKm | 417.00 |
| ČSOB IC XXXVIII. (4th worst - Healthcare) | CZ0000300694 | 15. 7. 2015 | CZKm | 134.12 |
| ČSOB IC XXXIX. (Defensive SX5E) | CZ0000300702 | 22. 7. 2015 | CZKm | 142.41 |
| ČSOB Investiční certifikát Unit link III. | CZ0000300710 | 10. 8. 2015 | CZKm | 230.82 |
| ČSOB Investiční certifikát Unit link IV. | CZ0000300728 | 10. 9. 2015 | CZKm | 261.82 |
| ČSOB Investiční certifikát Unit link V. | CZ0000300769 | 10. 11. 2015 | CZKm | 493.00 |
| ČSOB Investiční certifikát XLII. (Banks Defensive) | CZ0000300785 | 2. 12. 2015 | CZKm | 176.24 |
| ČSOB Investiční certifikát XLIII. (Eurostoxx50) | CZ0000300819 | 9. 12. 2015 | EURm | 3.59 |
| ČSOB Investiční certifikát XLIV. (Eurostoxx50) | CZ0000300827 | 16. 12. 2015 | USDm | 3.06 |
| ČSOB Investiční certifikát Unit link VI. | CZ0000300793 | 21. 12. 2015 | CZKm | 572.70 |
| Participation SX5E 2021 | CZ0000300843 | 9. 2. 2016 | CZKm | 62.60 |
| ČSOB Investiční certifikát Unit link VII. | CZ0000300884 | 22. 2. 2016 | CZKm | 763.20 |
| Participation SX7P 2021 | CZ0000300892 | 16. 3. 2016 | CZKm | 39.89 |
| ČSOB Investiční certifikát Unit link VIII. | CZ0000300900 | 11. 4. 2016 | CZKm | 194.83 |
| ČSOB Investiční certifikát CLN 2020 | CZ0000300967 | 11. 4. 2016 | CZKm | 500.00 |
| ČSOB Investiční certifikát Unit link IX. | CZ0000300959 | 24. 5. 2016 | CZKm | 191.50 |
| ČSOB Investiční certifikát Unit link X. | CZ0000300983 | 15. 7. 2016 | CZKm | 124.30 |
| ČSOB Investiční certifikát Unit link XI. | CZ0000301031 | 12. 9. 2016 | CZKm | 116.25 |
| Evropská inflace a Euro Stoxx 50 2021 | CZ0000301049 | 21. 9. 2016 | CZKm | 82.15 |
| ČSOB Investiční certifikát Unit link XII. | CZ0000301064 | 24. 10. 2016 | CZKm | 324.95 |
| Solactive Participation 2021 | CZ0000301072 | 3. 11. 2016 | CZKm | 220.34 |
| ČSOB Investiční certifikát Unit link XIV. | CZ0000301148 | 12. 12. 2016 | CZKm | 502.41 |
| Gold Miners | CZ0000301163 | 21. 12. 2016 | CZKm | 194.70 |
| ČSOB Investiční certifikát Unit link XIII. | CZ0000301130 | 29. 12. 2016 | CZKm | 582.26 |
| Defensive SX5E 4,6 2024 II. | CZ0000301171 | 29. 12. 2016 | CZKm | 118.09 |
| ČSOB Investiční certifikát Unit link XV. | CZ0000301189 | 30. 12. 2016 | CZKm | 129.80 |
| ČSOB Investiční certifikát Unit link XVI. | CZ0000301197 | 10. 2. 2017 | CZKm | 191.23 |
| Autocall Euro iSTOXX 70 EWD5 6,8 2022 | CZ0000301213 | 8. 3. 2017 | CZKm | 430.36 |
| Defensive Euro iSTOXX 70 EWD5 4 2024 | CZ0000301205 | 8. 3. 2017 | CZKm | 248.60 |

| Issue Name | ISIN | Issue Date | Volume of Investment Certificates Issued (Nominal Value) | |
|---|---|---|---|---|
| ČSOB Investiční certifikát Unit link XVII. | CZ0000301239 | 10. 3. 2017 | CZKm | 125.18 |
| Defensive Eurostoxx 4,6 2024 III. | CZ0000301254 | 15. 3. 2017 | CZKm | 308.85 |
| NYSE Arca Gold BUGS 5,1 2022 | CZ0000301288 | 15. 3. 2017 | CZKm | 173.55 |
| ČSOB TOP 70 EVROPSKÝCH SPOLEČNOSTÍ 1 | CZ0000301247 | 5. 4. 2017 | CZKm | 316.61 |
| ČSOB Investiční certifikát Unit link XVIII. | CZ0000301304 | 12. 4. 2017 | CZKm | 103.47 |
| NXS Momentum Fund Stars ER Participation 2022 | CZ0000301296 | 19. 4. 2017 | CZKm | 917.64 |
| ČSOB Investiční certifikát Unit link XIX. | CZ0000301338 | 10. 5. 2017 | CZKm | 137.20 |
| Worst of IT 6 2022 | CZ0000301346 | 11. 5. 2017 | CZKm | 177.61 |
| ČSOB Investiční certifikát Unit link XX. | CZ0000301361 | 14. 6. 2017 | CZKm | 124.03 |
| ČSOB Investiční certifikát Unit link XXII. | CZ0000301387 | 13. 7. 2017 | CZKm | 249.80 |
| ČSOB Investiční certifikát Unit link XXI. | CZ0000301379 | 14. 7. 2017 | CZKm | 97.00 |
| BNP Income Fund Stars ER 2022 | CZ0000301395 | 19. 7. 2017 | CZKm | 695.00 |
| Autocall iStoxx Transatlantic 100 EWD 6,1 2022 | CZ0000301411 | 21. 7. 2017 | CZKm | 327.00 |
| Defensive Eurostoxx 4,3 2024 | CZ0000301403 | 26. 7. 2017 | CZKm | 241.00 |
| Europe Dividend basket 7 2022 | CZ0000301437 | 6. 9. 2017 | CZKm | 405.00 |
| Defensive iStoxx Transatlantic 100 EWD 4 2024 | CZ0000301486 | 1. 11. 2017 | CZKm | 200.00 |
| ČSOB Investiční certifikát Unit link XXIII. | CZ0000301429 | 14. 8. 2017 | CZKm | 86.57 |
| ČSOB Investiční certifikát Unit link XXIV. | CZ0000301445 | 14. 9. 2017 | CZKm | 193.20 |
| ČSOB Investiční certifikát Unit link XXV. | CZ0000301460 | 23. 10. 2017 | CZKm | 16.74 |
| ČSOB Investiční certifikát Unit link XXVI. | CZ0000301478 | 11. 10. 2017 | CZKm | 233.94 |
| ČSOB Investiční certifikát Unit link XXVII. | CZ0000301536 | 22. 12. 2017 | CZKm | 550.92 |
| ČSOB Investiční certifikát Unit link XXVIII. | CZ0000301494 | 10. 11. 2017 | CZKm | 41.83 |
| NXS Momentum Fund Stars ER Participation 2022 II. | CZ0000301502 | 22. 11. 2017 | CZKm | 170.00 |
| ČSOB Investiční certifikát Unit link XXIX. | CZ0000301510 | 14. 11. 2017 | CZKm | 184.63 |
| Defensive Eurostoxx 4,6 2024 | CZ0000301551 | 28. 12. 2017 | CZKm | 438.74 |
| Europe 5 2024 | CZ0000301544 | 27. 12. 2017 | CZKm | 342.71 |
| ČSOB Investiční certifikát Unit link XXX. | CZ0000301528 | 29. 12. 2017 | CZKm | 226.57 |

**In the first three months 2018***, ČSOB issued the following investment certificates issues in the Czech Republic:

| Issue Name | ISIN | Issue Date | Volume of Investment Certificates Issued (Nominal Value) | |
|---|---|---|---|---|
| ČSOB Investiční certifikát Unit link XXXI. | CZ0000301577 | 12. 2. 2018 | CZKm | 103.76 |
| Best of Participation 2023 | CZ0000301627 | 7. 3. 2018 | CZKm | 141.60 |
| Defensive SX5E USD 5,4 2025 | CZ0000301650 | 7. 3. 2018 | USDm | 3.11 |
| Autocall SX5E EUR 4,6 2023 | CZ0000301668 | 7. 3. 2018 | EURm | 2.00 |
| ČSOB Investiční certifikát Unit link XXXII. | CZ0000301635 | 12. 3. 2018 | CZKm | 96.70 |
| Banky 5 2023 | CZ0000301643 | 21. 3. 2018 | CZKm | 416.92 |

** Issued until 31 March 2018*

All ČSOB's investment certificates are unlisted (not publicly tradable on any official regulated market in either an EU member state, or an EEC member state).

The prospectus of investment certificates, amendments thereto and pricing supplements are available at ČSOB's website www.csob.cz.

The purpose of the issuance of bonds and of investment certificates by ČSOB is mainly to enlarge the offer of investment products for the Bank's clients.

## Activity of ČSOB

**ČSOB is active as a universal bank in the Czech Republic.**

**As a legal entity subject to the Czech law, ČSOB follows the applicable legislation in force in the territory of the Czech Republic.** Its activities are regulated primarily under the Banking Act, the Capital Market Undertakings Act and by the Corporations Act. **A single banking licence** is of fundamental importance for ČSOB's business activities. ČSOB is also authorized to provide services of a tied insurance intermediary and is participant of the Central Depository.

### Main Areas of Activities

**ČSOB's Scope of Business is defined in the Articles of Association of ČSOB** (in the part III. Scope of Business).

ČSOB, being a universal bank, carries out banking transactions and renders financial services according to the generally binding legal regulations of the Czech Republic regulating the domestic and foreign activities of banks. In particular, **it accepts deposits from the public and provides loans**.

**In addition to these basic services, ČSOB is authorized to carry out the following activities according to the applicable Czech legal regulations:**

- Investment in securities on the Bank's own account,
- Financial leasing,
- Payments and clearance,
- Issuance and administration of payment instruments,
- Provision of guarantees,
- Issuance of letters of credit,
- Provision of collection services,
- Provision of all investment services according to a special law,
- Issuance of mortgage bonds,
- Financial brokerage,
- Provision of depository services,
- Exchange office services (purchase of foreign exchange),
- Provision of banking information,
- Trading in foreign exchange values and gold on the Bank's own account or on a client's account,
- Rental of safe-deposit boxes,
- Activities directly related to the activities mentioned above, and
- Activities carried out for other parties if they relate to the running of the company and operation of other banks, financial institutions and enterprises providing ancillary banking services, controlled by the company.

## Significant Contracts

**Out of the ordinary course of ČSOB's business, the Bank has entered into no contracts** which could result in any group member being under an obligation or entitlement that is material to ČSOB's ability to meet its obligation to security holders in respect of the securities being issued.

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 was effective until the end of 2017. It was replaced by a new ten-year agreement with effect from January 1, 2018.

## Trademarks, Licenses, Patents

Being aware of the ever-growing importance of intellectual property as a vital and integral part of the modern society, ČSOB pays extraordinary attention to the intellectual property rights and their protection.

ČSOB is the applicant/owner of more than a hundred **trademarks** registered with the trademark authorities established to protect industrial or other intellectual property rights and uses the trademarks for product and service identification when performing its business activities.

ČSOB is a holder of many **licenses**, mainly software products licenses, to support ČSOB's business activities.

ČSOB is not a **patent** applicant/owner.

## Governmental, Legal or Arbitration Proceedings

*which may have, or have had in the recent past, significant effects on ČSOB's and / or the ČSOB group's financial position or profitability.*

### Information on Court Disputes

For information on court disputes please refer to the Separate Financial Statements for the year 2017 (Notes 27 and 33) and to the Consolidated Financial Statements for the year 2017 (Notes 29 and 35).

The most significant ČSOB's court disputes as at 31 December 2017, are shown in the following table including the dispute amount (with accessories).

**Litigation against ČSOB** (the Defendant)

| Counterparty of the Dispute | Liability (CZKm) |
|---|---|
| ICEC-HOLDING, a.s., Boleslavova 710/19, Ostrava | 22,313 |

According to ČSOB, this legal dispute does not constitute any risk, given its absolute unreasonableness. If, however it is improbable situation, ČSOB would be obliged to provide any payment on the basis of the legally binding decision in this dispute, ČSOB would consider to claim the reimbursement of such payment from CNB, under the Agreement and Indemnity concluded in connection with the sale of the IPB Enterprise.

## Expenses on Research and Development

In 2017, ČSOB had outlays of CZK 1,284 m for research and development (2016: CZK 1,372 m). Most of these outlays were related to investments into large information technologies projects and smaller development of existing applications as well as development studies and implementation of individual projects, mainly in the area of information technologies and systems, including development of internet applications.

# Other Information

## Remuneration Charged by Auditors for 2017

*Information in accordance with Section 118 (4) (k) of the Act No. 256/2004 Coll., Capital Market Undertakings Act*

| Type of Service (CZKths; excluding VAT*) | ČSOB | Consolidated ČSOB Unit |
|---|---|---|
| Statutary audit of annual financial statements | 18,725 | 30,106 |
| Other assurance services | 1,979 | 1,979 |
| Tax advisory | 0 | 0 |
| Other non-audit services | 97 | 97 |
| Training / consultation | 130 | 130 |
| **Total** | **20,931** | **32,312** |

** Published information includes relevant part of VAT, which is not deductible.*

## Contribution to the Securities Traders Guarantee Fund

*Information in accordance with Section 16 (1) of the Act No. 256/2004 Coll., Capital Market Undertakings Act*

As a securities trader, ČSOB contributes to the Guarantee Fund, which ensures the guarantee system from which compensation is paid to the clients of a securities trader that is not able to fulfil its obligations to its clients.

| Contribution to the Securities Traders Guarantee Fund for 2017 (CZKths) | ČSOB | Consolidated ČSOB Unit* |
|---|---|---|
| Basis for calculation of the contribution | 1,097,423 | 1,312,391 |
| **The contribution** | **21,941** | **26,240** |

** Including Patria Finance (the company started to be consolidated from 1 January 2015).*

*Contribution of ČSOB AM (CZK 1,524 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 2017.*

# Information Published within this Annual Report

| Information | Reference[1] |
|---|---|
| Important Events and Significant Changes in 2017 | Report of the Board of Directors |
| | Corporate Governance Policy |
| | Note 3[2] |
| New Products and Services Introduced in 2017 | Report of the Board of Directors |
| Description of Markets where ČSOB Competes | Company Profile |
| | Report of the Board of Directors |
| Profit Distribution | Note 13 |
| Activities Undertaken in the Area of Environmental Protection[3] | Corporate Social Responsibility |
| Information on Entities Included into the ČSOB Consolidated Financial Statements as at 31 December 2017 | Companies of the ČSOB group |
| | Note 3[2] |
| Expected Economic and Financial Situation of ČSOB in 2018 | 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 2017 (unless stated otherwise).*
*2) The content refers to a note in Notes to the Consolidated Financial Statements for the year 2017.*
*3) Together with this Annual Report, ČSOB also publishes the ČSOB Group Report to Society 2017.*

# Annex to Additional Information

Information according to Annex 14 of the Decree No. 163/2014 Coll., on the Performance of the Activities of Banks, Credit Unions and Investment Firms

# Events after the Reporting Period

| Chapter | Part |
|---|---|
| Corporate Governance | Managing and Supervisory Bodies, ČSOB's Organisation Chart |
| Additional Information | Bonds and Investment Certificates |
| Notes to the Consolidated Financial Statements for the year 2017 | Events after the Reporting Period (Note 39) |
| Notes to the Separate Financial Statements for the year 2017 | Events after the Reporting Period (Note 37) |

# Information on the Publication of the ČSOB Annual Report 2017

**ČSOB will publish its Annual Report 2017 on its Internet website at www.csob.cz.**

The **Czech National Bank** will add the ČSOB Annual Report 2017 to the collection of deeds of the **Register of Companies** pursuant to Section 21a of the Accounting Act.

Information in accordance with Section 99 of Decree No. 163/2014 Coll., on the Performance of the Activities of Banks, Credit Unions and Investment Firms

Annual reports and other obligatory information are available (by the date of release of this Annual Report) on ČSOB's Internet website in the section ČSOB – **Obligatory Published Information** (Povinně uveřejňované informace):

*https://www.csob.cz/portal/about-csob/obligatory-published-information#vyrocni-zpravy.*

# Annex to Additional Information

## Global Reporting Initiative (GRI) Content index*

*General Standard Disclosures*

| General disclosures 2017 | Description | cross-reference |
|---|---|---|
| **Organizational Profile** | | |
| 102–1 | Name of the organization | Annual Report 2017, p. 1. |
| 102–2 | Activities, brands, products and services | Annual Report 2017, p. 19–24, 26, 36, 44, 92, 291–292, 301. |
| 102–3 | Location of headquarters | Annual Report 2017, p. 1. |
| 102–4 | Location of operations | Annual Report 2017, p. 11, 26, 36, 301. |
| 102–5 | Ownership and legal form | Annual Report 2017, p. 1, 26, 28, 36. |
| 102–6 | Markets served | Annual Report 2017, p. 5, 26, 36. |
| 102–7 | Scale of the organization | Annual Report 2017, p. 7, 18, 26–27. |
| 102–8 | Information on employees and other workers | Annual Report 2017, p. 2, 13, 27, 30, 33–34, 88, 97; ČSOB Group Report to Society 2017. |
| 102–9 | Supply chain | Suppliers Policy, ČSOB Group Report to Society 2017. |
| 102–10 | Significant changes to the organization and its supply chain | Annual Report 2017, p. 8, 48–49. |
| 102–11 | Precautionary Principle or approach | Integrity Policy ČSOB, ČSOB Compliance Statut, Ethical Code, Annual Report 2017, p. 30–32, 47, 58, 63, 134–170; ČSOB Group Report to Society 2017. |
| 102–12 | External initiatives | Annual Report 2017, p. 30–33, 302–303; ČSOB Group Report to Society 2017. |
| 102–13 | Members of associations | not stated |
| **Strategy** | | |
| 102–14 | Statement from CEO | Annual Report 2017, p. 3. |
| **Ethics and Integrity** | | |
| 102–16 | Values, principles, standards and norms of behavior | Ethical Code, Integrity Policy ČSOB, ČSOB Compliance Statut, Annual Report 2017, p. 3, 11, 16, 30–32, 34, 47, 58; ČSOB Group Report to Society 2017. |
| **Governance** | | |
| 102–18 | Governance structure | Annual Report 2017, p. 64–65. |
| **Stakeholder Engagement** | | |
| 102–40 | List of stakeholder groups | Annual Report 2017, p. 30; ČSOB Group Report to Society 2017. |
| 102–42 | Identifying and selecting stakeholders | ČSOB Group Report to Society 2017. |
| 102–43 | Approach to stakeholder engagement | ČSOB Group Report to Society 2017. |
| 102–44 | Key topics and concerns raised | ČSOB Group Report to Society 2017. |

| General disclosures 2017 | Description | cross-reference |
|---|---|---|
| **Report Profile** | | |
| 102–45 | Entities included in the consolidated financial statements | Annual Report 2017, p. 289, 297. |
| 102–46 | Defining report content and topic boundaries | Annual Report 2017, p. 4. |
| 102–47 | List of material topics | ČSOB Group Report to Society 2017. |
| 102–49 | Changes in reporting | Annual Report 2017, p. 305. |
| 102–50 | Reporting period | Annual Report 2017, p. 305. |
| 102–51 | Date of most recent report | Annual Report 2017, p. 305. |
| 102–52 | Reporting cycle | Annual Report 2017, p. 305. |
| 102–53 | Contact point for questions regarding the report | Annual Report 2017, p. 321. |
| **Specific GRI Standards** | | |
| 103–1 | Explanation to the material topic and its boundary | Integrity Policy ČSOB, ČSOB Compliance Statut, Ethical Code; ČSOB Group Report to Society 2017. |
| 103–2 | The management approach | Integrity Policy ČSOB, ČSOB Compliance Statut, Ethical Code, Annual Report 2017, p. 3, 11, 30, 32, 34, 58; ČSOB Group Report to Society 2017. |
| 103–3 | Evaluation of the management approach | Integrity Policy ČSOB, ČSOB Compliance Statut, Ethical Code; ČSOB Group Report to Society 2017. |
| **Economic (GRI 200)** | | |
| 201–1 | Direct economic value generated and distributed | Annual Report 2017, p. 2, 7, 13–15, 67–71; ČSOB Group Report to Society 2017. |
| 201–2 | Financial implications and other risk and opportunities due to climate change | Annual Report 2017, p. 9–10; ČSOB Group Report to Society 2017. |
| 203–1 | Infrastructure investments and services supported | Annual Report 2017, p. 14, 102–104, 205–210; ČSOB Group Report to Society 2017. |
| 203–2 | Significant indirect economic impacts | Annual Report 2017, p. 9–10. |
| 205–1 | Operations assessed for risks related to corruption | Annual Report 2017, p. 31, 47, 58. |
| 205–2 | Communication and training about anti-corruption policies and procedures | ČSOB Anticorruption Policy, ČSOB Whistle-blowing Policy, Ethical Code, ČSOB Anticorruption program, ČSOB Policy for Donations and Similar Performances, Policies for Notification, Investigation and Documentation of Unethical, Fraudulent and Criminal Law in ČSOB, Strategy for the Prevention and Detection of Fraud and Ethics of ČSOB Group; ČSOB Group Report to Society 2017. |

| General disclosures 2017 | Description | cross-reference |
|---|---|---|
| **Environmental (GRI 300)** | | |
| 302–1 | Energy consumption within the organization | Annual Report 2017, p. 30–31; ČSOB Group Report to Society 2017; ČSOB Environmental Policy. |
| 302–4 | Reduction of energy consumption | Annual Report 2017, p. 30–31; ČSOB Group Report to Society 2017; ČSOB Environmental Policy. |
| 305–1 | Direct (Scope 1) GHG emissions | Annual Report 2017, p. 30–31; ČSOB Group Report to Society 2017; ČSOB Environmental Policy. |
| 305–2 | Energy indirect (Scope 2) GHG emissions | Annual Report 2017, p. 30–31; ČSOB Group Report to Society 2017; ČSOB Environmental Policy. |
| 305–3 | Other indirect (Scope 3) GHC emissions | Annual Report 2017, p. 30–31; ČSOB Group Report to Society 2017; ČSOB Environmental Policy. |
| 305–5 | Reduction of GHG emissions | Annual Report 2017, p. 30–31; ČSOB Group Report to Society 2017; ČSOB Environmental Policy. |
| **Social (400)** | | |
| 401–1 | New employee hires and employee turnover | Annual Report 2017, p. 88, 97; ČSOB Group Report to Society 2017. |
| 404–1 | Average hours of training per year per employee | ČSOB Group Report to Society 2017. |
| 404–3 | Percentage of employees receiving regular performance and career development reviews | ČSOB Group Report to Society 2017. |
| 405–1 | Diversity of governance bodies and employees | Annual Report 2017, p. 34, 47–49; ČSOB Group Report to Society 2017. |
| **Own indicators** | | |
| | Initiatives to improve access to financial services for disadvantaged people | Annual Report 2017, p. 30–32; ČSOB Group Report to Society 2017. |
| | Anti-corruption policies and procedures | ČSOB Anticorruption Policy, ČSOB Whistle-blowing Policy, Ethical Code, ČSOB Anticorruption program, ČSOB Policy for Donations and Similar Performances, Policies for Notification, Investigation and Documentation of Unethical, Fraudulent and Criminal Law in ČSOB, Strategy for the Prevention and Detection of Fraud and Ethics of ČSOB Group; ČSOB Group Report to Society 2017. |
| | Policies with specific environmental and social components applied to business lines. | ČSOB Environmental Policy, ČSOB Energetic Policy; ČSOB Group Report to Society 2017. |
| | Process(es) for improving staff competency to implement the environmental and social policies and procedures as applied to business lines | ČSOB Environmental Policy, ČSOB Energetic Policy, ČSOB Anticorruption Policy, ČSOB Whistle-blowing Policy, Ethical Code, ČSOB Anticorruption program; ČSOB Group Report to Society 2017. |

**This sustainability Report has been prepared in accordance with the GRI Standards, "Core" option, non-financial data have not been externally audited.*

# Annex to Additional Information

## Information according to Annex 14 of Decree No. 163/2014 Coll.,

*on the Performance of the Activities of Banks, Credit Unions and Investment Firms*

### Information about Capital and Capital Requirements pursuant to Article 437 (1) (a) of Regulation (EU) 575/2013

| (CZKths) | | the Bank 31. 12. 2017 | Regulated Cons. Unit 31. 12. 2017 |
|---|---|---|---|
| Items from Statement of Financial Position | **Total Shareholders' Equity** | **83,779,494** | **93,703,711** |
| | Share capital | 5,855,000 | 5,855,000 |
| | Share premium | 20,092,666 | 20,928,552 |
| | Accumulated Other comprehensive income | 1,864,591 | 1,986,716 |
| | Reserve funds | 18,686,648 | 18,686,648 |
| | Retained earnings for the previous periods | 21,924,260 | 28,729,927 |
| | Own shares | 0 | 0 |
| | Net profit for the period | 15,356,330 | 17,516,868 |
| | Non-controlling interest | 0 | 0 |
| Adjustments to CET1 | **Total Adjustments to CET1** | **(21,663,492)** | **(24,605,392)** |
| | Gains / (losses) on hedging instruments (Cash Flow Hedging) | (496,844) | (496,844) |
| | Additional value adjustment | (147,420) | (132,115) |
| | Goodwill | (2,178,017) | (2,030,907) |
| | Other intangible assets, net of tax | (2,606,334) | (3,818,432) |
| | Insufficient coverage of expected credit losses (lack of provisions) | (878,548) | (1,807,538) |
| | Unusable profit | (15,356,330) | (16,312,300) |
| | Non-controlling interest | 0 | 0 |
| | Deferred tax assets | 0 | (7,256) |
| | Other transitional adjustments to CET 1 | 0 | 0 |
| Tier 2 Capital | **Total Tier 2 Capital** | **0** | **0** |
| | IRB Excess of provisions over expected losses eligible | 0 | 0 |
| | **Total Capital** | **62,116,001** | **69,098,319** |
| | **Tier 1 (T1) Capital** | **62,116,001** | **69,098,319** |
| | **Common Equity Tier 1 (CET1) Capital** | **62,116,001** | **69,098,319** |
| | **Tier 2 (T2) Capital** | **0** | **0** |

## Information about Capital and Capital Requirements pursuant to Article 438 (c) to (f) of Regulation (EU) 575/2013

| (CZKths) | | | the Bank 31. 12. 2017 | Regulated Cons. Unit 31. 12. 2017 |
|---|---|---|---|---|
| In the case of institutions that calculate the exposure values according to part three title II chapter 2.8% of the exposure value for each category of exposure indicated in Article 112 of Regulation (EU) 575/2013 | Exposures to central governments or central banks | Article 438 (c) | 0 | 0 |
| | Exposures to regional governments or local authorities | | 0 | 0 |
| | Exposures to public sector entities | | 0 | 0 |
| | Exposures to multilateral development banks | | 0 | 0 |
| | Exposures to international organisations | | 0 | 0 |
| | Exposures to institutions | | 0 | 17,114 |
| | Exposures to corporates | | 0 | 525,159 |
| | Retail exposures | | 0 | 6,195 |
| | Exposures secured by mortgages on immovable property | | 0 | 46,869 |
| | Exposures in default | | 0 | 1,767 |
| | Exposures associated with particularly high risk | | 0 | 0 |
| | Exposures in the form of covered bonds | | 0 | 0 |
| | Items representing securitisation positions | | 0 | 0 |
| | Exposures to institutions and corporates with a short-term credit assessment | | 0 | 0 |
| | Exposures in the form of units or shares in collective investment undertakings | | 0 | 0 |
| | Equity exposures | | 4,046,605 | 87,167 |
| | Other items | | 0 | 179,427 |
| Capital requirements calculated according to Article 92 (3) (b) and (c) of Regulation (EU) 575/2013 | For position risk | Article 438 (e) | 49,187 | 43,954 |
| | For large exposures exceeding the limits set in Articles 395 to 401, if the institution is permitted to exceed these limits | | 0 | 0 |
| | For currency risk | | 0 | 362 |
| | For settlement risk | | 0 | 0 |
| | For commodity risk | | 0 | 0 |
| Capital requirements calculated according to part three title III chapters 2, 3 and 4 of Regulation (EU) 575/2013 and made available separately | Capital requirement pursuant to title III chapter 2 | Article 438 (f) | 0 | 0 |
| | Capital requirement pursuant to title III chapter 3 | | 4,037,973 | 4,549,778 |
| | Capital requirement pursuant to title III chapter 4 | | 0 | 0 |
| In the case of institutions that calculate the exposure values according to part three title II chapter 3.8% of the exposure value for each category of exposure indicated in Article 147. In the case of the retail exposure category, this requirement is used for each category of exposure that corresponds to differing correlation according to Article 154 (1) to (4) of Regulation (EU) 575/2013. | Exposures to central governments or central banks | Article 438 (d) | 712,668 | 783,870 |
| | Exposures to institutions | | 3,708,028 | 894,351 |
| | Exposures to corporates | | 9,741,144 | 9,592,673 |
| | Retail exposures | | 2,150,954 | 9,889,481 |
| | Equity exposures | | 0 | 0 |
| | Items representing securitisation positions | | 0 | 0 |
| | Other assets not having the character of a credit liability | | 2,296,563 | 2,810,746 |
| In the case of the equity exposures category this requirement is used for | Equity exposures traded on regulated markets | | 0 | 0 |
| | Equity exposures not traded on regulated markets in sufficiently diversified portfolios and other exposures | | 0 | 0 |
| | Exposures that in the area of capital requirements are subject to transitional supervision rules | | 0 | 0 |
| | Exposures that in the area of capital requirements are subject to provisions relating to retention of legal effects | | 0 | 0 |
| | Each of the approaches indicated in Article 155 | | 0 | 0 |
| *Risk exposure for credit valuation adjustment ** | | | *208,104* | *208,104* |
| *Risk exposure amount for Position, foreign exchange and commodities risks under internal models ** | | | *2,545,184* | *2,545,184* |

** This items was added for observance of required reporting CNB..*

## Capital Ratios

| | the Bank | Regulated Cons. Unit |
|---|---|---|
| | 31. 12. 2017 | 31. 12. 2017 |
| Capital ratio for Equity capital Tier 1 | 16.85% | 17.18% |
| Capital ratio for Tier 1 capital | 16.85% | 17.18% |
| Capital ratio for Total capital | 16.85% | 17.18% |

## Ratios Indicators

| | | the Bank |
|---|---|---|
| | | 31. 12. 2017 |
| Return on average assets (ROAA) | | 1.13% |
| Return on average Tier 1 capital (ROAE) | | 24.35% |
| Assets per employee* | CZKths | 175,421 |
| Administrative costs per employee* | CZKths | 1,775 |
| Profit after tax per employee* | CZKths | 2,093 |

** According to CNB's methodology (Registered number of employees).*

# DOCUMENTS

## Sworn Statement

### Persons Responsible for the ČSOB Annual Report 2017

hereby declare that, to their best knowledge, the ČSOB Annual Report 2017 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 and on non-financial information.

In Prague, 19 April 2018

Československá obchodní banka, a. s.

**John Arthur Hollows**
Chairman of the Board of Directors

**Jiří Vévoda**
Member of the Board of Directors

# Independent Auditor's Report

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## *Independent auditor's report*

**to the shareholder of Československá obchodní banka, a.s.**

**Report on the Audit of the Consolidated and Separate Financial Statements**

***Our Opinion***

In our opinion:

- The accompanying consolidated financial statements give a true and fair view of the consolidated financial position of Československá obchodní banka, a.s., with its registered office at Radlická 333/150, Prague 5 ("the Company") and its subsidiaries (together "the Group") as at 31 December 2017, of their consolidated financial performance and their consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

- The accompanying separate financial statements give a true and fair view of the financial position of the Company standing alone as at 31 December 2017, of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

We confirm that the audit opinion expressed herein is consistent with the additional report to the Audit Committee of the Company, which we issued on 29 March 2018 in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and of the Council ("the EU Regulation").

*What we have audited*

The Group's consolidated financial statements comprise:

- The consolidated statement of income for the year ended 31 December 2017;
- The consolidated statement of other comprehensive income for the year then ended;
- The consolidated statement of financial position as at 31 December 2017;
- The consolidated statement of changes in equity for the year then ended;
- The consolidated statement of cash flows for the year then ended; and
- The notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

The Company's separate financial statements comprise:

- The statement of income for the year ended 31 December 2017;
- The statement of other comprehensive income for the year then ended;
- The statement of financial position as at 31 December 2017;
- The statement of changes in equity for the year then ended;
- The statement of cash flows for the year then ended; and
- The notes to the separate financial statements, which include significant accounting policies and other explanatory information.

***Basis for Opinion***

We conducted our audit in accordance with the Act on Auditors, EU Regulation and Standards on Auditing of the Chamber of Auditors of the Czech Republic. These standards consist of International Standards on Auditing (ISAs) which may be supplemented and modified by related application guidance. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

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

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PricewaterhouseCoopers Audit, s.r.o., registered seat Hvězdova 1734/2c, 140 00 Prague 4, Czech Republic, Identification Number 40765521, registered with the Commercial Register kept by the Municipal Court in Prague, Section C, Insert 3637, and in the Register of Audit Companies with the Chamber of Auditors of the Czech Republic under Evidence No 021

**Shareholder of Československá obchodní banka, a.s.**
**Independent auditor's report**

## *Independence*

We are independent of the Group and Company in accordance with the Act on Auditors, EU Regulation and Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) and accepted by the Chamber of Auditors of the Czech Republic, and we have not provided any non-audit services that are prohibited under Article 5 of the EU Regulation and fulfilled our other ethical responsibilities in accordance with these regulations.

## *Our audit approach*

### *Overview*


Overall materiality for the consolidated financial statements represents 5% of Group's profit before tax and has been determined as CZK 1,044 million.

Overall materiality for the separate financial statements represents 5% of the Company's profit before tax and has been determined as CZK 886 million.

Our audit work addressed 98% of the Group's assets and 95% of the Group's profit before tax.

- Credit risk and impairment of loans;
- Valuation of complex financial instruments.

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated and separate financial statements (together "financial statements"). In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

### *Materiality*

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for each set of the financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on each set of the financial statements.

| | |
|---|---|
| **Overall Group materiality** | CZK 1,044 million |
| **How we determined it** | Overall materiality figure represents 5% of the Group's profit before tax. |
| **Rationale for the materiality benchmark applied** | We have chosen the profit before tax as a benchmark for estimating materiality, as the Group is a profit-oriented entity. We understand that profit before tax is one of the key performance indicators for the Group's stakeholders. Profit before tax has been developing consistently over last years. We have chosen 5%, which is within the range of acceptable quantitative materiality thresholds for Public Interest Entities. |
| **Overall materiality for the separate financial statements** | CZK 886 million |

**Shareholder of Československá obchodní banka, a.s.**
**Independent auditor's report**

| | |
|---|---|
| **How we determined it** | Overall materiality figure represents 5% of the Company's profit before tax. |
| **Rationale for the materiality benchmark applied** | We have chosen the profit before tax as a benchmark for estimating materiality, as the Company is a profit-oriented entity. We understand that profit before tax is one of the key performance indicators for the Company's and stakeholders. Profit before tax has been developing consistently over last years. We have chosen 5%, which is within the range of acceptable quantitative materiality thresholds for Public Interest Entities. |

### *Key Audit Matters*

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

| Key audit matters | How our audit addressed the key audit matters |
|---|---|
| **Credit risk and impairment of loans** | |
| We focused on this area because management make complex and subjective judgements over both timing of recognition of impairment loss and the estimation of the size of any such impairment loss.<br>In Corporate and Small and Medium Enterprise segments of loans and advances, the material portion of impairment loss is individually calculated. For Retail loans and advances impairment loss is calculated on a collective basis. Collective impairment allowances are calculated using models which approximate the impact of current economic and credit conditions on portfolio of loans.<br>We focused our audit on the following areas of impairment specifically relating to:<br>• The key assumptions and judgements made by the management that underlie the calculation of modelled unsecured retail impairment. Key assumptions and judgements include the emergence period used for unidentified impairment, the probability of default calculation and loss incurred in the case of default;<br>• The post model adjustments recorded as a result of back-test done;<br>• The completeness of loans and advances that are included in the impairment calculation; and<br>• The individual calculation of impairment loss, where we focused on estimation of expected cash-flows from the loans, including estimated income from loan collateral.<br>See Note 40.2 to the consolidated financial statements and Note 38.2 to the separate financial statements for policies used by management to determine impairment estimates. | We assessed and tested the design and operating effectiveness of the controls over impairment loss related data and calculations. These controls included those over the identification of which loans and advances were impaired, transfer of data and the calculation of the impairment provision. We determined that we can rely on these controls for the purpose of our audit.<br>We tested the basis and operation of the models used for impairment loss calculation, as well as data and assumptions used. Our work included the following:<br>• We tested the entity level controls over the end to end model process in relation to model monitoring and validation, model inputs and outputs and management adjustments. We determined that we can rely on these controls for the purposes of our audit;<br>• We performed a detailed testing on a sample of models used to calculate impairment loss. This testing varied by portfolio, but typically included review of the model design documentation, re-performance of the calculation and testing the reliability of the data used in calculation. We have not identified any weaknesses in the design and functionality of the used models;<br>• We tested post model adjustments, including considering the basis for the adjustment, the logic applied, the source data used and the key assumptions adopted. We found no material exceptions during our testing of the post model adjustments.<br>We assessed and tested controls for monitoring and measurement of collateral, including assessment of the quality of external experts used by the Company and the Group. We determined that we can rely on these controls for the purposes of our audit.<br>Where impairment was individually calculated, we tested controls over the timely identification of potentially impaired loans and controls over calculation of the impairment loss. We determined that we can rely on these controls for the purposes of our audit. We tested a sample of loans and advances to ascertain whether the loss event had been identified in time. |

**Shareholder of Československá obchodní banka, a.s.**
**Independent auditor's report**

| Key audit matters | How our audit addressed the key audit matters |
|---|---|
| **Credit risk and impairment of loans** | |
| | Where impairment had been identified, we examined the business valuation or forecasts of future cash flows prepared by management to support the calculation of the impairment loss and explored the assumptions used. We found no material exceptions in these tests.<br><br>We examined a sample of loans and advances which had not been identified by management as potentially impaired and formed our own judgement as to whether that was appropriate including using external evidence in respect of the relevant counterparties. We found no material exceptions in these tests. |
| **Valuation of complex financial instruments** | |
| The fair value of securities and derivatives (including ALM derivatives and ALM swap positions) involves a number of observable and unobservable inputs, which are subjective in nature.<br><br>In addition, in accordance with IFRS 13, the Group and the Company need to disclose mandatory information about the fair values of financial instruments in the financial statements. Major area of our focus were financial instruments classified in level 3 of the fair value hierarchy. These financial instruments include non-liquid financial instruments, exotic financial derivatives and structured derivative products.<br><br>See Note 32 to the consolidated financial statements and Note 30 to the separate financial statements for fair value disclosures, valuation techniques and significant unobservable inputs used by management to determine fair value of these financial instruments. | We focused our audit procedures in respect of fair values of these financial instruments on the adequacy of the valuation methodology, completeness and accuracy of data representing these financial instruments in the Company's information systems and on the valuation inputs.<br><br>In particular, our procedures consisted of:<br>• Assessment of valuation methodology and valuation models. We consider the methodology and models used by the Group appropriate.<br>• Detailed reconciliation of a sample of market observable inputs to the independent market data. Market observable inputs used by the Group corresponded to the respective market data identified by us.<br>• Detailed reconciliation of valuation adjustments inputs to the independent market sources. The valuation adjustments inputs were reconciled without differences.<br>• Assessment of reasonableness of significant unobservable valuation inputs. We consider these as reasonable.<br>• Testing of set of automated, IT dependent and manual controls aimed on completeness and accuracy of data held within the Company's information systems. We consider the controls to operate effectively.<br>• Circularisation of sample of counterparties to confirm the existence of financial instruments. We found no material unconfirmed financial instruments.<br>• Independent recalculation of fair value on a sample of financial instruments. Our recalculation did not identify any significant differences. |

### *How we tailored our audit scope*

We tailored the scope of our audit in order to perform sufficient work to enable us to provide opinion on each set of the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which the Group and the Company operate.

Decisions regarding multi-location scoping require a significant degree of professional judgment based on the unique facts and circumstances of each entity. Most importantly, we considered each entity's contribution to total assets and profit before tax of the Group.

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**Shareholder of Československá obchodní banka, a.s.**
**Independent auditor's report**

Our coverage for the 2017 year-end audit of the consolidated financial statements of the Group is 95% of total consolidated assets (after eliminations), which is covered by full scope audit procedures, and additional 1% covered by specified procedures on CSOB Leasing, a.s. At the same time this also represents almost 95% of the consolidated profit before tax covered by full scope audit procedures and close to 3% covered by specified procedures on CSOB Leasing, a.s.

### *Other Information*

In compliance with Section 2(b) of the Act on Auditors, the other information comprises the information included in the Annual Report other than both of the financial statements and auditor's report thereon. The Board of Directors is responsible for the other information.

Our opinion on the financial statements does not cover the other information. In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge about the Group and the Company obtained in the audit or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law and regulation, in particular, whether the other information complies with law and regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

- The other information describing the facts that are also presented in the financial statements is, in all material respects, consistent with the financial statements; and
- The other information is prepared in compliance with applicable law and regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Group and the Company obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.

### *Responsibilities of the Board of Directors and Supervisory Board for the Financial Statements*

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

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

The Supervisory Board is responsible for overseeing the financial reporting process.

### *Auditor's Responsibilities for the Audit of the Financial Statements*

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

As part of an audit in accordance with the above stated requirements, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal controls relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group and the Company's internal controls.

**Shareholder of Československá obchodní banka, a.s.**
**Independent auditor's report**

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.
- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group and the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group or the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the notes, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the Board of Directors, Supervisory Board and Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

## *Report on Other Legal and Regulatory Requirements*

In compliance with Article 10(2) of the EU Regulation, we provide the following information in our independent auditor's report, which is required in addition to the requirements of International Standards on Auditing:

*Appointment of Auditor and Period of Engagement*

We were appointed as the auditors of the Company and the Group by the General Meeting of Shareholders on 22 April 2016 for three-year period and our uninterrupted engagement has lasted for 2 years.

*Provided Non-audit Services*

The non-audit services are disclosed in the Additional Information note of the Annual Report.

*Non-financial information*

In accordance with § 32i of the Act on Accounting, we hereby report that the Company has prepared the non-financial information for the year ended 31 December 2017 and disclosed it in its Annual Report.

19 April 2018

PricewaterhouseCoopers Audit, s.r.o.

PricewaterhouseCoopers Audit, s.r.o.
represented by

Marel Richter

Marek Richter, FCCA
Statutory Auditor, Evidence No. 1800

Note

Our report has been prepared in the Czech language and in English. In all matters of interpretation of information, views or opinions, the Czech version of our report takes precedence over the English version.

# ABBREVIATIONS

| Abbreviation | Business Company |
|---|---|
| ČSOB<br>the Bank | Československá obchodní banka, a. s. |
| PSB | Poštovní spořitelna (Postal Savings Bank; part of ČSOB) |
| ČSOB group | group of companies of the ČSOB group (not a legal entity) |

| Abbreviation | Business Company |
|---|---|
| BANIT | Bankovní informační technologie, s.r.o. |
| Bausparkasse Schwäbisch Hall | Bausparkasse Schwäbisch Hall AG |
| CBCB | CBCB - Czech Banking Credit Bureau, a.s. |
| Centrum Radlická | Centrum Radlická a.s. |
| CNB | Czech National Bank |
| CZSO | Czech Statistical Office |
| ČMSS | Českomoravská stavební spořitelna, a.s. |
| ČSOB Advisory | ČSOB Advisory, a.s. |
| ČSOB AM / ČSOB Asset Management | ČSOB Asset Management, a.s., investment company |
| ČSOB Factoring | ČSOB Factoring, a.s. |
| ČSOB Leasing | ČSOB Leasing, a.s. |
| ČSOB Leasing pojišťovací makléř | ČSOB Leasing pojišťovací makléř, s.r.o. |
| ČSOB PF Stabilita | ČSOB Penzijní fond Stabilita, a. s., a member of the ČSOB group |
| ČSOB PS / ČSOB Penzijní společnost | ČSOB Penzijní společnost, a. s., a member of the ČSOB group |
| ČSOB Pojišťovna | ČSOB Pojišťovna, a. s., a member of the ČSOB holding |
| ČSOB Pojišťovací servis | ČSOB Pojišťovací servis, s.r.o., a member of the ČSOB holding |
| ČSOB Property fund | ČSOB Property fund, a.s. |
| ČSOB SK | Československá 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 Czech Branch | KBC Group NV Czech Branch, organizational unit |
| KBC Insurance / KBC Verzekeringen | KBC Insurance NV (i.e. KBC Verzekeringen NV) |
| KBC Lease Holding | KBC Lease Holding NV |
| KBC Participations Renta C | KBC Participations Renta C SA |
| KBC Securities | KBC Securities NV |
| Merrion Properties | Merrion Properties s.r.o. |
| MF CR | Ministry of Finance of the Czech Republic |
| Motokov | MOTOKOV a.s. in liquidation |
| Patria Corporate Finance | Patria Corporate Finance, a.s. |
| Patria Finance | Patria Finance, a.s. |
| Patria group | group of companies of parent company Patria Online (not a legal entity) |
| Patria investiční společnost / Patria IS | Patria investiční společnost, a.s. |
| Patria Online | Patria Online, a.s. |
| Radlice Rozvojová | Radlice Rozvojová, a.s. |
| SousedeCZ | SousedeCZ s.r.o. |
| Top-Pojištění | Top-Pojištění.cz s.r.o. |
| Transformed fund /<br>Transformed pension fund | Transformovaný fond Stabilita ČSOB Penzijní společnosti, a. s., a member of the ČSOB group |

# FINANCIAL CALENDAR

## Financial Calendar for 2018

ČSOB Group Unaudited Financial Results Releases
*(according to EU IFRS)*

| Financial Results | | Date of Release |
|---|---|---|
| as at 31 December 2017 | 4Q / FY 2017 | 22 February 2018 |
| as at 31 March 2018 | 1Q 2018 | 17 May 2018 |
| as at 30 June 2018 | 2Q / 1H 2018 | 9 August 2018 |
| as at 30 September 2018 | 3Q / 9M 2018 | 15 November 2018 |
| as at 31 December 2018 | 4Q / FY 2018 | February 2019 |

*Note:*
*This schedule is indicative only; terms might be subject to change during the year.*

# CONTACT DETAILS

## Investor Relations

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