KELER CENTRAL DEPOSITORY LTD.

Consolidated Financial Statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union
and
Independent Auditor's Report

for the year ended 31 December 2017

CONTENTS

Explanation of the abbreviations used in the financial statements:

AC	Financial asset measured at amortized cost
AFS	Available-for-sale (financial instruments)
ARO	Asset retirement obligation
CBH	Central Bank of Hungary
CCP	Central Counterparty (may mean: clearing house)
CGU	Cash-generating unit
ECC	European Commodity Clearing
ECL	Expected Credit Loss
EMIR	European Market Infrastructure Regulation
EPS	Earnings per share
CRR	Capital Requirement Regulation
FVTOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
HAS	Hungarian Accounting Regulation
HTM	Held to maturity (financial asset)
IAS	International Accounting Standards
IFRIC/SIC	Interpretations of the International Financial Reporting Standards
IFRS	International Financial Reporting Standards
LR	Loans and receivables (financial asset)
MHUF	Million Hungarian forints
WACC	Weighted average cost of capital

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of KELER Ltd.

Opinion

We have audited the consolidated financial statements of KELER Ltd. and its subsidiaries (the „Group”) for the year 2017 which comprise the consolidated statement of financial position as at December 31, 2017 – which shows a total assets of HUF 136,958 million –, and the related consolidated statement of comprehensive income – which shows a net income for the period of HUF 2,986 million –, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and notes to the consolidated financial statements including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at December 31, 2017 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (the „EU IFRS”), and the consolidated financial statements were prepared in all material respects in accordance with the provisions of the effective Hungarian Act C of 2000 on Accounting (hereinafter: "the Accounting Act") relevant to the entities preparing consolidated financial statements in accordance with EU IFRS.

Basis for Opinion

We conducted our audit in accordance with the Hungarian National Standards on Auditing and the effective Hungarian laws and other regulations on audits. Our responsibilities under these standards are further described in the "*The Auditor's Responsibilities for the Audit of the Consolidated Financial Statements*" section of our report.

We are independent of the Group in compliance with the relevant effective Hungarian regulations and the “Rules of conduct (ethical rules) of the auditor profession and the disciplinary process” of the Chamber of Hungarian Auditors and, in respect of matters not regulated therein, the “Code of Ethics for Professional Accountants” (the IESBA Code) issued by the International Ethics Standards Board for Accountants, and we have fulfilled our other ethical responsibilities in accordance with the same ethical requirements.

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

Key Audit Matters

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

Key audit matter	How our audit addressed the matter
Valuation of the intangible assets	
(See Note 11 of the notes to the consolidated financial statements for the details.) As at December 31, 2017 the net book value of the intangible assets is HUF 784 million. The determination of the amortization and impairment of the intangible assets requires the application of professional judgement and use of highly subjective assumptions by management. The current year's impairment amount of the intangible assets is HUF 3,342 million. The most significant assumptions and estimations applied in calculation of the impairment are the followings: • commitment to finalize the software development, • calculation of future economic benefits, • calculation of recoverable amounts. Based on the significance of the above described circumstances the valuation of the intangible assets was identified as a key audit matter.	The relevant audit procedures performed by us included the followings: • review of project plans, • testing the design and operative effectiveness of key controls over amortization policy and calculating and recording of impairment, • sample based testing of amortization and impairment, including the review of assumptions and estimations, • review of subsequent events and assessment of their impacts on the reporting period, • review of relevant disclosures.

Other Matters

The consolidated financial statements of KELER Ltd. and its subsidiaries for the year ended December 31, 2016 were audited by another auditor who expressed an unmodified opinion on those statements on April 19, 2017.

Other Information: The Consolidated Business Report

Other information includes the consolidated business report of the Group for 2017. Management is responsible for the preparation of the consolidated business report in accordance with the relevant provisions of the Accounting Act and other regulations. Our opinion on the consolidated financial statements provided in the section of our independent auditor's report entitled „Opinion" does not apply to the consolidated business report.

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

Furthermore, in accordance with the Accounting Act, our responsibilities also include assessing whether the consolidated business report was prepared in accordance with the relevant provisions of the Accounting Act and other regulations, and to express an opinion on the above and on whether the consolidated business report is consistent with the financial statements.

In our opinion, the consolidated business report of the Group for 2017 corresponds to the consolidated financial statements of the Group for 2017 and the relevant provisions of the Accounting Act in all material respects. As the Group is not subject to additional requirements under any other regulation in connection with the consolidated business report, we have not formulated an opinion on this matter.

In addition to the above, based on the information obtained about the Group and its environment, we must report on whether we became aware of any material misstatements in the consolidated business report and, if so, on the nature of such material misstatements. We have nothing to report in this regard.

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

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

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

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

The Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives during the audit are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue, on the basis of the above, 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 Hungarian National Standards on Auditing and the effective Hungarian laws and other regulations on audits will always detect a material misstatement when it exists. Misstatements can arise from fraud or error, and they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with the Hungarian National Standards on Auditing and the effective Hungarian laws and other regulations on audits, we exercise professional judgment and maintain professional scepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor’s report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify the 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 to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion

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

We also provide those charged with governance 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 those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our 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 Regulation (EU) No. 537/2014 of the European Parliament and the Council, 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 the Auditor and the Period of Engagement
We were appointed as the auditors of the KELER Ltd. by the General Meeting of Shareholders on May 17, 2017 and our uninterrupted engagement has lasted since our appointment.

Consistence with the Additional Report to the Audit Committee
We confirm that our audit opinion on the consolidated financial statements expressed herein is consistent with the additional report to the Audit Committee of the KELER Ltd., which we issued on May 11, 2018 in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.

Provision of Non-audit Services
We declare that no prohibited non-audit services referred to in Article 5 (1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided by us to the Group. In addition, there are no other non-audit services which were provided by us to the KELER Ltd. and its controlled undertakings and which have not been disclosed in the consolidated business report.

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

Budapest, May 11, 2018

The original Hungarian version has been signed

Nagyváradiné Szépfalvi Zsuzsanna
on behalf of Deloitte Auditing and Consulting Ltd.
and as a statutory registered auditor

Deloitte Auditing and Consulting Ltd.
1068 Budapest, Dózsa György út 84/C.
Registration number: 000083

Registration number of statutory registered auditor: 005313

	Notes	**31.12.2017**	**31.12.2016**
Cash and cash equivalents	5	24 564	31 901
Placements with other banks	5	41 300	21 232
Available for sale financial assets	6	50 570	53 119
Current tax assets	9	219	115
Deferred tax assets	17	3	2
Trade receivables relating to gas market	7	4 135	3 482
Receivables relating to clearing and depository activities	8	662	510
Receivables from foreign clearing houses	10	13 595	7 926
Other receivables	9	840	383
Intangible assets	11	784	3 451
Property, plant and equipment	12	286	411
TOTAL ASSETS		**136 958**	**122 532**
Deposits from customers	15	96 388	80 655
Liabilities for Guarantee Funds	16	5 828	5 425
Current tax liability	14	-	-
Deferred tax liability	17	57	223
Trade payable from gas market activity	7	4 106	3 500
Trade payables	13	224	362
Provisions for onerous contract	26	786	-
Other payables	14	673	571
TOTAL LIABILITIES		**108 062**	**90 736**
Share capital	18	4 500	4 500
Retained earnings		23 780	24 292
Statutory reserves	19	122	2 596
Available for sale financial asset revaluation reserve	29	494	408
Equity holders of the Parent Company		28 896	31 796
Non-controlling interest		-	-
TOTAL SHAREHOLDERS' EQUITY		**28 896**	**31 796**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**136 958**	**122 532**

The accompanying notes to consolidated financial statements on pages 13 to 80 form an integral part of these consolidated financial statements.

	Notes	**01.01.2017-31.12.2017**	**01.01.2016-31.12.2016**
Income from clearing and depository activity	21	**5 750**	**5 389**
Interest income	22	1 072	1 814
Interest expense	22	(163)	(436)
Net interest income		**909**	**1 378**
Gains on securities, net	23	**72**	**107**
Income from the principal activity		**6 731**	**6 874**
Bank fees, commissions and similar items	24	(209)	9211)
Personnel expenses	25	(2 423)	(2 210)
Depreciation and amortization		(518)	(563)
IT support	26	(847)	(819)
Expert fees	26	(236)	(74)
Telecommunication fees	26	(75)	(76)
Other expenses	26	(2 031)	(1 016)
Operating expenses		**(6 339)**	**(4 969)**
Impairment losses	11	(3 342)	-
Other income and expenses	27	53	44
Operating profit		**(2 897)**	**1 949**
Other financial income and expenses	27	(3)	(21)
Financial income		**(3)**	**(21)**
INCOME BEFORE INCOME TAX		**(2 900)**	**1 928**
Income taxes	28	(86)	(271)
NET INCOME FOR THE PERIOD		**(2 986)**	**1 657**
Other comprehensive income:			
Remeasurement gains/losses of available for sale financial instruments	6	95	400
Translation difference on foreign operation		-	-
Income tax of other comprehensive income	17	(9)	(32)
Other comprehensive income for the period		**86**	**368**
Of which later to be reclassified to net income:		86	368
Of which later not to be reclassified to net income:		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**(2 900)**	**2 025**

All profit or loss and other comprehensive income is attributable to the shareholders of Parent Company.

The accompanying notes to consolidated financial statements on pages 13 to 80 form an integral part of these consolidated financial statements.

	Share Capital	Available for sale financial asset revaluation reserve	Retained Earnings	Statutory reserves	**Equity holders of the Parent Company**	**Non-controll-ing interest**	**Total**
Balance as of 1 January 2016	**4 500**	**40**	**22 769**	**2 455**	**29 764**	**7**	**29 771**
Acquisition of non-controlling interest	-	-	7	-	7	(7)	-
Total comprehensive income for the year	-	368	1 657	-	2 025	-	2 025
Transfer to statutory reserves	-	-	(141)	141	-	-	-
Balance as of 31 December 2016	**4 500**	**408**	**24 292**	**2 596**	**31 796**	**-**	**31 796**
Balance as of 1 January 2017	**4 500**	**408**	**24 292**	**2 596**	**31 796**	**-**	**31 796**
Total comprehensive income for the year	-	86	(2 986)		(2 900)	-	(2 900)
Transfer to statutory reserves	-	-	2 474	(2 474)	-	-	-
Balance as of 31 December 2017	**4 500**	**494**	**23 780**	**122**	**28 896**	**-**	**28 896**

The accompanying notes to consolidated financial statements on pages 13 to 80 form an integral part of these consolidated financial statements.

	01.01.2017 31.12.2017	**01.01.2016 31.12.2016**
CASH FLOW FROM OPERATING ACTIVITIES		
PROFIT BEFORE TAXES	(2 900)	1 928
Interest expense	163	436
	(2 737)	*2 364*
Non-cash items - adjustments		
Interest income	(1 072)	(1 814)
Depreciation and amortization charged	518	563
Adjustment due to incentive on lease	-	9
Recognition of provision	786	-
Unrealized gain on cash and cash equivalents	(7)	-
Impairment of intangible assets	3 342	-
Expenses from disposal of property plant and equipment and intangible assets	-	4
Gain on disposing property plant and equipment	(7)	(3)
Remeasurement of FVTPL financial assets	-	-
Changes in the guarantee fund liability	403	1 050
Operating cash-flow before working capital adjustments	**1 226**	**2 173**
Proceeds/(cash used) in gas market transactions, net	(47)	62
Changes of the deposits of clients, net (loro accounts)	15 733	(59 619)
Cash payments to other clearing houses	(5 669)	(1 848)
Increase in trade and other receivables	(608)	(208)
Increase/(decrease) in trade and other payables	(144)	314
Cash proceeds from financial instruments	2 644	21 666
Net (increase) / decrease in placements with other banks, net of allowance for losses	(20 068)	845
	(6 933)	*(36 614)*
Interest paid	(172)	(485)
Income tax paid	(367)	(494)
Net cash used in operation	**(7 472)**	**(37 593)**
CASH FLOW FROM INVESTING ACTIVITIES		
Acquisition of property, plant and equipment	(64)	(83)
Acquisition of intangible asset	(892)	(1 423)
Cash proceeds from disposal of property plant and equipment	13	9
Cash proceeds from / (cash spent on) financial assets held for investing purposes	-	-
Proceeds from interest	1 071	1 811
Cash provided by investing activity	**128**	**314**

The accompanying notes to consolidated financial statements on pages 13 to 80 form an integral part of these consolidated financial statements.

	01.01.2017 31.12.2017	**01.01.2016 31.12.2016**
CASH FLOW FROM FINANCING ACTIVITIES		
Cash generated/(used) from/in financing activity	**-**	**-**
Net decrease in cash and cash equivalents	(7 344)	(37 280)
Opening cash and cash equivalents	31 901	69 181
Closing cash and cash equivalents	24 564	31 901
Unrealized gain on cash and cash equivalents	7	-
Net decrease in cash and cash equivalents	(7 344)	(37 280)

The accompanying notes to consolidated financial statements on pages 13 to 80 form an integral part of these consolidated financial statements.

NOTE 1: GENERAL

Statement of IFRS compliance

The financial statements of KELER Central Depository Ltd. (hereinafter referred as “KELER” or “Company” or “Parent Company”) and its’ consolidated subsidiaries (also referred to as together the ‘Entity’ or ‘Group’) were prepared in accordance with IFRSs. The management declares that the Group fully complied with the provisions of IFRSs/IASs and IFRICs/SICs as endorsed by the European Union applicable in the current period. The management made this declaration in full awareness of its responsibility.

The management determined that the Group will be able to continue as a going concern, which means that there are no signs that would indicate that the Group intends to terminate or significantly reduce its operations in the foreseeable future.

These financial statements were prepared using the accrual basis.

The Group generally measures its assets on a historical cost basis, except for cases where a given item should be measured at fair value under IFRS. Additional disclosures about measurement basis further discussed in Note 2.

Presentation of the Company (legal form, seat)

The KELER Central Depository Ltd. is a limited liability company incorporated under the laws of Hungary on 12 October 1993. The official address of the company: H-1074 Budapest, Rákóczi str. 70-72.

The KELER Central Depository Ltd. is a special credit institution operating pursuant to Act CXX of 2001 on the Capital Market and Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises. The Company’s primary activities are central securities depository services, specialized bank services, issuer services and ancillary CSD services. Supervisory authority order 33001/1994. designated KELER Ltd. to undertake central securities depository activities in Hungary.

KELER CCP Ltd., as a subsidiary of KELER (“KELER CCP”) was founded by KELER and BSE in 2008.

KELER CCP was founded as a limited liability company according to the Hungarian laws. In 2011, KELER CCP was transformed to a private company limited by shares. Company’s seat: H-1074 Budapest, Rákóczi str. 70-72.

KELER CCP’s owners on 31 December 2017

- KELER 99.72%
- CBH 0.15%
- BSE 0.13%

The ultimate owners did not change since the last period. KELER CCP is a central counterparty business association pursuant to the requirements of the Act CXX of 2001 on Capital Market (“Act on Capital Market”) operating and guaranteeing the settlement of stock exchange and over-the-counter transactions. KELER CCP as central counterparty undertakes guarantee for transactions concluded on the Budapest Stock Exchange and for the financial performance of the gas market (Daily natural gas and capacity trading market) transactions. KELER CCP as general clearing member undertakes guarantee for the financial performance of power market transactions towards European Commodity Clearing AG. KELER CCP's direct partners are commodities service, securities service providers, financial institutions, participants of an organized market, or organizations performing clearing house activity. KELER CCP's activity ensures that market participants' guaranteed trades are settled risk free.

The upper limit of the settlements guarantee set is based on the equity of the Group.

KELER CCP founded a company in 2014. KELER Energy Luxembourg s.a.r.l. (also referred to as "LUX") was founded with a share capital of EUR 50,000 and 100% owned by KELER CCP and therefore a consolidated subsidiary of this Group. This entity was to take part in the settlement process of physically delivered gas market and other energy market transactions, however in 2016 the Board decided that this activity will not be launched. Therefore LUX started a voluntarily liquidation in November 2016. This process was finished in January 2017. Due to the unwinding of the entity the net assets of the subsidiary was included in the 2016 figures (which is 53 812 tHUF deficit (negative balance) but in 2017 the entity was disposed of, so the net assets are not included in the statement of financial position. The pervious translation differences recorded in other comprehensive income released.

One of the shareholder of the Company (Central Bank of Hungary) regularly enters into transactions with Entity. These transactions are not regarded as shareholder transactions since they are done on regular business terms same as if they were done with independent parties.

Changes in the group structure

KELER CCP had one subsidiary until the beginning of 2017. This subsidiary was disposed. The Group consolidated the results of the subsidiary and the effect of the deconsolidation until the day of the disposal. The financial statements prepared by KELER CCP are considered to be consolidated in aspect of Consolidated Statement of Comprehensive Income, but the data to current period in Consolidated Statement of Financial Position reflects only one entity (KELER CCP).

NOTE 2: BASIS OF PREPARATION

a) Basis of measurement

The Group generally measures its assets and liabilities on historical cost basis, except for cases where a given item should be measured at fair value under IFRS. Latter one includes derivatives and available for sale financial assets that are stated at fair value.

b) Functional currency, presentation currency

Items included in the consolidated financial statements are measured using Hungarian Forint, which is the currency of the primary economic environment in which the Group operates ('the functional currency'). LUX's functional currency is EUR which is translated to Hungarian forint in these financial statements. Latter only has effect in 2016, since the LUX was disposed of.

These consolidated financial statements are presented in Hungarian Forints rounded to the nearest million ("MHUF").

c) Use of estimates and judgements

The preparation of consolidated financial statements in accordance with IFRS requires the management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual result may differ from these estimates.

In preparing its financial statements, the Group made critical estimates in connection with the following topics, which, as a result, are sources of uncertainty.

The fair value of the financial instruments are valued at fair value as required by the IFRSs. These fair values are mostly quoted prices or based on quoted prices (Level 1 and Level 2). However they may change significantly over time leading to significantly different values as expected at the measurement day.

Items measured at fair value, which is Level 3 measurement is especially judgmental, since the input date was determined based on information not directly observable. The information regarding the level of measurement of the items is provided in Note 34.

The useful lives, the residual values and the recoverable amounts of intangible assets and property, plant and equipment are all based on estimates. Changes in these estimates may significantly change reported figures

Deferred tax assets and liabilities depend on the legal environment. Changes in the legal environment may result in a significant change in the value of such items.

The management's judgment in calculating the impairment of financial assets is an important decision which directly impacts net profit.

Certain items of the Group's assets can be tested for impairment at CGU level only. Identifying CGUs requires complex professional judgment. In addition, when determining the recoverable value of CGUs, the Group's management is forced to rely on forecasts for the future which are uncertain by nature.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate revised and in any future period affected.

NOTE 3: SIGNIFICANT ACCOUNTING POLICIES

a) Basis of consolidation

Subsidiaries

The Group consists of the Parent Company and the subsidiaries. The Group includes all entities which are directly or indirectly controlled by the Parent Company.

The Group contains a subgroup (KELER CCP as an intermediate parent, and LUX as a subsidiary). The consolidated financial statement of the subgroup is also available for use.

Starting from the financial year beginning on 1 January 2014, control is defined in accordance with IFRS 10. According to this standard, an investor has control over an investee if it has rights to the variable positive returns generated by the investee and bears the consequences of negative returns and has the ability to direct operations and, as a result, to affect those returns through its decisions (power). This power arises from rights.

Control is primarily obtained through equity ownership, agreements with other shareholders or a special market position (e.g. monopoly). KELER obtained control over all of the entities included in these financial statements by virtue of equity ownership.

Associates and joint arrangements

The Group does not have associates or joint arrangements during the presented periods.

Transactions eliminated during consolidation

Intercompany balances and transactions, and any unrealized gains arising from intercompany transactions are eliminated in preparing the consolidated financial statements.

Goodwill

Goodwill arising in a business combination is measured initially as the excess of the cost of the business combination over the acquirer’s interest in the net fair value of the acquired identifiable assets, liabilities and contingent liabilities recognized. Goodwill is subject to an annual impairment test.

Negative goodwill

Negative goodwill arising in a business combination is measured initially as the excess of the net fair value of the acquired identifiable assets, liabilities and contingent liabilities recognized over the cost of the business combination. Negative goodwill that arise during the year is credited to the profit or loss.

b) Foreign currency transactions

Transactions in foreign currencies are translated to Hungarian forint at the foreign exchange rate effective at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the end of reporting period are translated to Hungarian forint at the foreign exchange rate effective at that date. Foreign exchange differences arising on translation are recognized in the Consolidated Statement of Comprehensive Income. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Hungarian forint at foreign exchange rates ruling at the dates the values were determined.

The financial statements of foreign operations (if any) is translated into Hungarian forints. The Group is using the closing rate method for the translation. The assets and liabilities are translated to HUF at the rate effective at the end of reporting period, the items of the Statement of Comprehensive Income are translated at the average rate for the relevant period (as an approximation of the date of each transaction). The elements of equity is translated at historical rate.

c) Cash and cash equivalents

Cash includes deposits repayable on demand. Cash equivalents are liquid investments with insignificant risk of value change and maturity of three months or less when acquired. Typically certain state bonds and treasury bills may meet the foresaid definition. Cash and cash equivalents are carried at amortized cost in the Consolidated Statements of Financial Position.

d) Financial assets and financial liabilities

Classification

Financial assets or financial liabilities at fair value through profit or loss (FVTPL) are financial assets and financial liabilities that are classified as held for trading mainly for the purpose of profit-taking or are derivative instruments. The Group does not have any financial instruments at the end of this period which is classified to the category FVTPL due to its nature being held for trading.

Receivables relating to clearing and depository activities are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables.

Held-to-maturity assets are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity. These items are stated at amortized cost.

Available for sale financial assets are non-derivative instruments that are not classified as another category of financial assets. This category mainly includes financial instruments that are purchased with the objective to invest surplus cash and similar items that are not traded actively, however certain trading activity may occur. The financial assets acquired by the Group for investing and cash flow balancing purposes are classified to this (AFS) category.

Other liabilities contain all financial liabilities that were not classified as at fair value through profit or loss.

Other liabilities contain placements and loans from other banks, deposits from customers, liabilities relating to clearing and depository activities.

Recognition

Financial assets and liabilities are entered into the Group’s books on the settlement day, except for derivative assets, which are entered on the trade day. Financial assets or financial liabilities are initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the financial assets expire or the Group transfers substantially all risks and rewards of ownership of the financial asset (without retaining significant right).

Measurement

Subsequent to initial recognition, all financial assets or financial liabilities at fair value through profit or loss and all available for sale assets are measured at fair value. If no quoted market price exists from an active market and fair value cannot be reliably measured, the Group uses valuation techniques to determine fair value.

All financial liabilities other than at fair value through profit or loss, held to maturity financial instruments and originated receivables are measured at amortised cost less impairment. For financial assets premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

A gain or loss on a financial asset or financial liability classified as at fair value through profit or loss shall be recognised in the Consolidated Statement of Comprehensive Income (as net income, ie. element of profit or loss), as gains and loss on securities.

A gain or loss on an available-for-sale financial asset shall be recognised in other comprehensive income, except for permanent impairment losses of equity instruments and foreign exchange gains and losses of debt instruments, until the financial asset is derecognised, at which time the cumulative gain or loss previously recognised in other comprehensive income shall be recognised in the statement of comprehensive income, as gains and loss on securities.

For financial assets and financial liabilities carried at amortised cost, a gain or loss is recognised in the Consolidated Statement of Comprehensive Income when the financial asset or financial liability is derecognised or impaired, and through the amortisation process (as net income).

Fair value measurement

The fair value of financial instruments is based on their quoted market price at the end of reporting period without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is estimated using valuation models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on the Group's economic estimates and the discount rate is a market related rate at the end of reporting period for an instrument with similar terms and conditions. Where valuation models are used, inputs are based on market related measures at the balance sheet date.
Level 1: The input for the fair value is the unadjusted quoted price, no other input is used for the valuation.
Level 2: All inputs are directly or indirectly observable but there are inputs other than the quoted price.
Level 3: The fair value of derivatives that are not exchange-traded are estimated at the amount that the Group would receive upon normal business conditions to terminate the contract at the end of reporting period taking into account current market conditions and the current creditworthiness of the counterparties.

Amortised cost measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction for impairment or uncollectability for financial assets.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through 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 shall not consider future credit losses.

Impairment of financial assets

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 discounted at the financial asset's original effective interest rate. The amount of the loss is recognised in the Consolidated Statement of Comprehensive Income, as other expenses.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired (ie. the decline is permanent), the cumulative loss that had been previously recognized there shall be reclassified to profit or loss, even though the financial asset has not been derecognized.

Impairment losses recognised in the statement of comprehensive income for an investment in an equity instrument classified as available for sale shall not be reversed through net income (the increase will be reported as OCI).

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 profit or loss, the impairment loss shall be reversed, with the amount of the reversal recognised in the profit or loss.

For the impairment review of AFS financial assets the decline is permanent if it is prolonged or material. For these purposes the Group take a decline prolonged if it is longer than 12 months or the loss in the value exceeds 10% below acquisitions price, considering last periods closing balance.

Financial assets are assessed individually or collectively. All individually significant financial assets are assessed for specific impairment. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortised cost) with similar risk characteristics.

e) Accounting for impairment losses other than financial instruments and identifying CGUs

The Group tests its significant assets for impairment each year. Testing consists of two stages. The first stage is to examine whether there are signs indicating that the assets in question are impaired. The following are signs that a given asset is impaired:
- damage;
- decline in income;
- unfavourable changes in market conditions and a decline in demand;
- increase in market interest rates.

Should there be any indication that an asset is impaired, a calculation which allows the recoverable amount of the asset to be determined is performed (this is the second step). The recoverable amount is the higher of the fair value of the asset reduced by the cost of disposal and the present value of the cash flows derived from continuous use.

First the impairment is determined on the level of the individual asset (if possible).

If the value in use of a group of assets cannot be determined as it does not generate any cash flows itself (it is not in use), the test is performed with respect to the cash-generating units (CGUs).

If the value in use can only be determined with respect to the CGUs and impairment needs to be accounted for, impairment losses are recognized as follows:

- first, damaged assets are impaired;
- second, goodwill is reduced;
- third, the remaining amount of impairment losses are split among property, plant and equipment (PPE) and intangible assets in the CGU in proportion to their carrying amount prior to impairment.

The value of assets may not drop below their fair value reduced by their individual cost of disposal.

Impairment testing is performed by the Group at the year-end or when it is clear that impairment needs to be recognised.

The impairment – in case of changes in the circumstances – may be reversed against net profit. The book value after the reversal may not be higher than the book value if no impairment loss was recognized previously.

The Group concluded that it has two CGUs. The CGUs are represented by the legal entities therefore the first CGU is the depository and specialized financial institution activities and other one is the CCP activity.

f) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairments, if any. Depreciation is provided using the straight-line method at rates calculated to write off the cost of the asset over its expected economic useful life. The rates used by the Group are 14.5% for building improvements, for automobiles 20%, 25% for office machines and computers and 14.5% for office equipment.

Expenditures incurred to replace a component of an item of property, plant and equipment that are accounted for separately, including major inspection and overhaul expenditures, are capitalized. Other subsequent expenditures are capitalized only when they increase the future economic benefits embodied in the item of property, plant and equipment. All other expenditures are recognized in the statement of comprehensive income as expense as incurred.

g) Intangible assets

Intangible assets are stated at cost less accumulated depreciation and impairments, if any. Depreciation is provided using the straight-line method at rates calculated to write off the cost of the asset over its expected economic useful life.
For software, valuable rights and interests 25% depreciation rate is used on a straight-line basis.

When the Group develops software to support the activities they decide about the eligibility of the capitalization according to the following criteria:

- the project is technically feasible
- there is an intention to complete the project
- the Group is able to use the asset (or sell it)
- the software will generate future economic benefits
- the resources needed to finish the projects are available
- the cost of the project is identifiable.

These criteria is also taken into consideration when the software is developed by external party, but it is coordinated by the Group.

If the Group acquires intangible assets with indefinite useful life the asset will be subject to annual impairment testing.

h) Trading on gas market

Based on the principle of the anonymity of the customers and the suppliers on the daily natural gas and capacity trading market, the transactions are made with the participation of KELER CCP. KELER CCP stands between the counterparties as a technical partner (customer and supplier) during the buying and selling transactions. The inventory of gas held by KELER CCP is always zero at the end of a day. Therefore, buying and selling of the gas is recorded by net method settlement in the Consolidated Statement of Comprehensive Income while in the accounts in Consolidated Statement of Financial Positions (receivables-liabilities) it is recorded gross.

i) Trading on energy market

KELER CCP as a general clearing member of European Commodity Clearing AG (ECC) maintains positions and clears the cash side of the trades to it’s non-clearing members towards ECC. KELER CCP receives all relevant information from ECC that is acting as central counterparty of all trades of the power market, and KELER CCP does guaranty all account transfer according the received information between ECC and the non-clearing members.

j) Sale and repurchase agreements and lending of securities

Securities sold subject to linked repurchase agreements ('repos') are retained in the financial statements as trading or investment securities with concurrent recognition of the counterparty liability. Securities purchased under agreements to resell ('reverse repos') are recorded as loans to customers. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective interest rate method while the securities are not recognized or derecognized in the financial statements. The loan receivables (in case of reverse repos) are subject to impairment testing taking into consideration the securities held.

k) Revenue recognition

- **Fee revenue**

The Group receives revenue for its guarantee, clearing and depository activities (including clearing on the gas and electricity market), such revenue is recognized when these services are performed.

- **Interest income**

Interest income is recognized in the profit or loss for all interest bearing instruments on an accrual basis using the effective interest method.

- **Trading activity**

Sales income is recognized on the trading day when the actual sales (and purchase) happen. See also above for trading on gas and energy market.

l) Income taxes

Income tax on the Consolidated Statement of Comprehensive Income for the year comprises current and deferred tax. Income tax is recognized in the profit or loss, except to the extent that it relates to items recognized in other comprehensive income, in which case it is recognized there.
Deferred income tax is provided, using the balance sheet method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the end of the reporting period.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.
A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized.
The Group considers all taxes that are charged to any level of profit or loss to be income taxes. Other taxes are presented separately from income taxes.

m) Provisions

A provision is recognized when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

n) Financial guarantee contract liability

The nature of the activity of the Entity requires to cover all the risk that are coming from default events (i.e. that KELEL CCP must settle the compensation of the transaction even if one of the parties of the clearing agreement is unable to pay/act). To deal with the statistically uncovered exposure the Entity recognizes a financial guarantee contract liability based on the available collateral and the probability of a loss event regardless how small this probability is.

o) Guarantee fund liability

As an element of the guarantee system, KELER CCP operates several collective guarantee funds. The purpose of the guarantee fund is to reduce the risk arising from default or failure of cleared and guaranteed transactions made by the Clearing Members. Contributions of the Members are kept in cash. These funds are recognized as liabilities and are measured at amortized cost.

p) Statutory reserves

i. General reserve

In accordance with Section 83 of Act CCXXXVII of 2013, a general reserve equal to 10% of the net after tax income is required to be made in the Hungarian statutory accounts. The general reserve, as calculated under Hungarian Accounting and Banking Rules, is treated as appropriations against retained earnings.

ii. General risk reserve

Under Section 87 of formerly effective Act CXII of 1996, a general risk reserve of maximum 1.25% of the risk weighted assets was made till 31 December 2013. This is a statutory reserve which can be used to cover unexpected credit losses only.

q) Hedging

The Group does not use hedge accounting for financial accounting purposes.

r) Statement of cash flows

Information about the cash flows of the Group is useful in providing users of financial statements with a basis to assess the ability of the Group to generate cash and cash equivalents and the needs of the Group to utilise those cash flows.

For the purposes of reporting cash flows, cash and cash equivalents include cash, balances, certain treasury bills and government bonds and placements with the National Bank of Hungary except those with more than three months maturity from the date acquisition.

s) Events after end of the reporting period

Events after the reporting period are those events, favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue. These events are adjusting and non-adjusting events.

All adjusting events after balance sheet date have been taken into account in the preparation of the consolidated financial statements of the Group. The material non-adjusting events after the end of the reporting period are presented in Note 38.

t) Off balance sheet items

KELER provides settlement service for certain contractual domestic partners regarding securities transaction made in the XETRA System of Deutsche Börse. KELER has a partnership with CITIBANK Frankfurt, which is a clearing member in XETRA Clearing AG. KELER CCP has to provide collateral for CITIBANK Frankfurt regarding XETRA settlement. KELER requires collateral from his clients at least the same size, but with a minimum amount of EUR 50.000. KELER CCP is entitled to require a collateral from its Clearing Members using its central counterparty services. The form of collateral can be cash, foreign exchange, securities and bank guarantees. As clearing member of European Commodity Clearing AG (ECC) KELER CCP has to provide collateral for ECC regarding the settlement of power market position of power market non-clearing members of KELER CCP.

NOTE 4: FINANCIAL RISK MANAGEMENT

a) Introduction and overview

The Management and the Board of Directors reviews regularly the principles of credit, market, liquidity and operational risk management of the Group.
Risk management function is separated from business.
KELER outsourced risk management tasks to KELER CCP, KELER CCP undertakes daily risk management tasks in line with a separate administrative order, however the Director of Risk Management at KELER is responsible for risk management and related decision making. KELER CCP measures and manages risks related to the central counterparty activity of KELER CCP.
The Group is exposed to the following main risk types arising from its operation and strategy:

- credit and counterparty risks,
- market risks,
- operational risks,
- general business risks,
- winding-down or restructuring risks

The exposures of the Group to the above risk types, the objectives, policy and procedures to measure and manage risks, and capital management by the Group are discussed below. The risks that are managed separately due to the different operation of the central securities depository and the central counterparty are covered separately for both entities.
Regarding risk management the compliance of the provisions of the CSDR1 has been changing demands in recent years. According to the requirements of the CSDR, KELER must be re-authorized for its central counterparty and banking services. The conditions for granting the authorization include a number of risk management requirements.
After long preparatory work, KELER submitted its reauthorization application to its Supervisory Authority on the 27th September 2017. The process is currently ongoing.
KELER is subject to the provisions of CSDR as a central securities depository which besides core services provides non-banking and banking-type ancillary services, therefore it shall comply with the Hungarian Market Act (Tpt.) and Hungarian Credit Act (Hpt.). KELER's risk assumptions are only reflected in the services listed in the CSDR. Hereinafter we refer to the activity of KELER as the central securities depository function, including the central securities depository and ancillary credit institution functions also.
As of 2014, KELER CCP operates as a qualifying central counterparty licensed under EMIR; thus, it complies with EU and Hungarian legislation regulating qualifying central counterparties. Hereinafter we refer to the activity of KELER CCP as the central counterparty function.
Changes in capital requirement stemming from different risk types are discussed in the chapter entitled Capital management.

[1] Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU (CSDR)

b) Investment risk

Two subcategories are defined under investment risk:

- credit and counterparty risks,
- market risks.

<u>Credit and counterparty risk</u>

Credit risk is the risk of loss impacting profitability and the capital position arising from default (or failure to perform as contracted) by the counterparty, i.e. from default on (on or off the balance sheet) liabilities towards the entity.

Counterparty risk is the potential loss arising from failure by the counterparty to meet contractual obligations before closing the transaction (final settlement of cash flows). As a type of credit risk, this risk typically relates to derivatives, repo and other securities financing transactions.

The various sub-types of credit and counterparty risks are introduced in the following chapters. Due to the activity undertaken by the Group, there is no risk taking arising from special lending exposures and FX lending. Off-balance sheet items related risks are considered under credit and counterparty risks. And the carrying amount of various classes of financial instruments generally best represents the maximum exposure to credit risk (which is reduced by collaterals given by customers, if any).

i. Credit and counterparty risk related to Treasury activity

Central securities depository function

Contrary to a traditional commercial bank, in the case of KELER credit risks are not considered complex and decisive; accordingly, this is not the risk with the greatest share in the capital requirement.

Pursuant to Article 46 of the CSDR, KELER applies the following investment policy:

1) KELER holds its financial assets at central banks, authorised credit institutions or authorised CSDs.

2) KELER has prompt access to its assets, when required. Financial resources are invested in cash or in highly liquid financial instruments with minimal market and credit risk. Investments are also capable of being liquidated rapidly with minimal adverse price effect (Hungarian government securities).

3) Investments that do not meet the aforementioned provisions (i. e. holdings), are fully deducted from own funds.

4) KELER also assures that investments remain within acceptable concentration limits.

In line with the above requirements the central securities depository can use the available funds of the shareholders' equity to perform the most common deal types that are the following:

- buy/sell of fixed rate government securities denominated in HUF
- repo trades
- FX transactions
- O/N or T/N interbank and MNB deposit placements,
- interbank and MNB loans.

In addition to narrowing the group of counterparties (credit institutions, investment firms, state entities, KELER CCP clearing and non-clearing members), the counterparty rating system, the daily monitoring system and the limit system ensure the comprehensive management, monitoring and reporting of counterparty risks inherent in the treasury activity by the central securities depository. As part of daily monitoring, KELER CCP Risk Management informs the Assets and Liabilities Committee on limit violations. The quarterly back testing by KELER CCP Risk Management informs regularly the Chief Risk Officer of KELER on the operation of the treasury limit system and any limit violations. The KELER Risk Management submits the annual summary on the operation of the limit system and any limit violations to the KELER's Asset-Liability Committee and the Board of Directors.

The central securities depository determines the capital requirements for credit and counterparty risks at both regulatory (CSDR, EBA RTS[2] supplementing CSDR , CRR[3]) and ICAAP-ILAAP level. On regulatory level the central securities depository applies the standard method pursuant to CRR, while under ICAAP-ILAAP it uses a method similar to the standard method applied under the regulatory level to calculate capital need, relying on the results of its own internal rating also to determine risk weights. There is no difference in determining the value of exposure under the two levels.

Central counterparty function

KELER CCP clearing members include credit institutions, investment firms and commodity exchange service providers in the capital market, in the energy markets cleared by the ECC and the gas markets (TP, CEEGEX) power and gas traders are the direct clients of KELER CCP. For KELER CCP as central counterparty, counterparty risk is financial (or securities) default by its clearing members and non-clearing members (in the energy market). Besides, exposures and liabilities related to fees may also arise due to the operation of KELER CCP.

In case of clearing member and energy market non-clearing member default on spot market purchase price, derivative market variation margin, KELER CCP as central counterparty is required to compensate non-defaulting participants in line with the default process, by using collaterals and guarantees, and its shareholders' equity also if needed. Therefore, counterparty risk monitoring and management are of outstanding importance to enable the central counterparty to assess potential exposures and have the appropriate amount of capital and liquid assets to compensate non-defaulting parties.

[2] Commission-delegated Regulation (EU) 2017/390 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on certain prudential requirements for central securities depositories and designated credit institutions offering banking-type ancillary services (EBA RTS)
[3] Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR)

KELER CCP rates regularly capital market clearing members, gas market clearing members and energy market non-clearing members according to objective (capital, liquidity and profitability indicators) and subjective aspects determined in its internal rating methodology. If the rating of a counterparty deteriorates significantly, KELER CCP pays special attention to the positions taken and uncovered risk, and based on individual assessment, on the grounds of perceived risk increase, it may impose additional financial collateral on the counterparty concerned.

The elements of the guarantee system are designed to cover credit risk arising from default by KELER CCP clearing and non-clearing members; no separate capital requirement is made. Due to the operation of the guarantee system, when the collateral requirement of a portfolio is determined, the counterparty risk factor is not quantified. In order to manage the resulting risk of negligible amount the existence of which cannot be examined historically, KELER CCP makes financial reserve in line with the bucket method. The part uncovered by the risk measure confidence level used to calculate collateral instruments and the maximum probability of occurrence were taken into account to determine financial reserve.

In line with the requirements of EMIR, KELER CCP calculates capital requirement on fee and trade receivables related to its credit risks based on CRR.

ii. Risk of CSD links, indirect contacts and intermediary institutions

Central securities depository function

KELER has relationship with several types of institutions by reasons of its involvement in the cross-border transactions and in relation to energy market performances that are intermediated for settlement by KELER CCP; consequently, exposures are generated to these institutions.

KELER’s foreign exchange account balances and exposures to CSDs that possess a banking authorization are determined on the basis of the business activities of the clients that use its settlement services; consequently, KELER has limited and indirect influence only due to its business activities.

A reliable and stable background and a good reputation are the key criteria when selecting CSD links, indirect relationships and intermediaries. In addition to the usual ratings, the result of the Due Diligence survey and the credit rating of the country where the registered office of the institution is located are also taken into account.

The quantification of the capital requirement is presented in chapter Credit and counterparty risk related to Treasury activity.

iii. Receivables From Other Counterparties (mostly fee receivables)

Central securities depository function

Other counterparties include natural and legal persons against which KELER may have a financial claim (or such claim may regularly occur) and those whose financial or other non-performance – not mentioned above – may cause financial loss for KELER or may have a negative impact on KELER’s operation (e.g. current or future financial claim, faulty or late performance or loss).

Other counterparties include partners that KELER creates a relationship with in the course of its operation (e.g.: buyers, suppliers, clients, participants, account holders, service providers.) The risk taking related to these partners is consciously limited by KELER, for example through the rules for the selection of suppliers. As KELER does not perform a counterparty rating in respect of such partners, no counterparty limits are set. The participants' risk assessment is carried out on a regular basis using KYC questionnaire in accordance with CSDR and ESMA RTS[4]. KELER sends the questionnaire to both key and other participants. Based on the data received, key participants are rated separately and a comprehensive, informative analysis on the other participants is performed for the KELER Management Board. The questionnaires shall be filled out biannually, but in case of key participants it is mandatory every year.

iv. Credit risk of holdings

Central securities depository function

KELER as central securities depository has a qualifying interest (99.72%) in KELER CCP, which is fully deducted from the own funds of the central securities depository. The part deducted from the own funds is not considered when capital requirement is determined, other exposures to KELER CCP are managed as credit and counterparty risks, as exposures to the company.

As the majority owner of KELER CCP, KELER assumes indirect risk for the contractual liabilities of KELER CCP towards contracted clearing members and energy market non-clearing members arising from the activity of KELER CCP as central counterparty.

As the holding is fully deducted from own funds, no further capital requirement is made.

Central counterparty function

KELER CCP is the sole shareholder of KELER Energy Luxembourg S.A.R.L, it is fully deducted to calculate the available capital of KELER CCP, the mentioned subsidiary was closed in the beginning of 2017, as a result of this KELER CCP has no other holdings.

v. Intra-day credit risk

Central securities depository function

Pursuant to Section C b) of the CSDR Annex, KELER provides a cash credit line only to KELER CCP, pursuant to the cooperation agreement, under full coverage. The purpose of the credit line is to promote smooth performance in the event of non-performance by the clearing members or energy market non-clearing members of KELER CCP.

vi. Off-balance sheet exposures

[4] Commission-delegated Regulation (EU) 2017/392 of 11 November 2016 supplementing Regulation (EU) No 909/2014 of the European Parliament and of the Council with regard to regulatory technical standards on authorisation, supervisory and operational requirements for central securities depositories (ESMA RTS)

KELER has off-balance sheet exposures only with respect to the cash credit provided to KELER CCP. The CRR contains the rules pertaining to putting off-balance sheet items on the balance sheet. As a result, the capital requirement is determined with the help of the weights specified in Article 111 of the CRR.

vii. Credit risk of international settlement

Central securities depository function

During 2017 the central securities depository provided access to the XETRA system of Deutsche Börse (foreign XETRA) for Hungarian market participants. The service covers guaranteed and non-guaranteed transactions also. For guaranteed transactions the operating model is as follows: Deutsche Börse trades are cleared by EUREX, KELER is involved as Settlement Agent through Citibank London (GCM, general clearing member) and Citibank Frankfurt (Settlement Agent)

Collateral collected in advance from clients and the capital requirement made provide adequate coverage for the risks inherent in settlement processes.

viii. Residual risk

Central securities depository function

Residual risk is the risk of large scale depreciation or restricted enforceability of credit exposures related collaterals, or in other words the risk that the recognized credit risk mitigation techniques applied by the credit institution prove to be less efficient than expected. For certain trades (e.g., repo trades), the central securities depository can accept collateral. In practice, credit risk mitigation instruments are accepted for repos, foreign XETRA trades and the cash-credit line offered for KELER CCP only.

In the case of KELER, this risk arises indirectly, through the holding, related to the collateral portfolio of KELER CCP. KELER CCP manages this risk satisfactorily, with haircuts in line with legislation, thus residual risk is minimal.

The central securities depository does not determine separate capital requirement for residual risks.

Central counterparty function

As part of the guarantee system operated by KELER CCP, the clients of KELER CCP are required to provide collateral. Instead of using the full market value, the collateral portfolio is taken into account after deduction of the haircuts determined in the valid KELER CCP condition lists on accepting securities and foreign currencies, this is a risk management technique to eliminate residual risk. The applicable condition list of KELER CCP determines the types of eligible collateral also; thus, jointly with the use of haircuts, residual risk is minimized.

The central counterparty does not determine separate capital requirement for residual risks either.

ix. Settlement risk

Settlement risk is the risk that a settlement executed through a payment system is performed in a way other than expected. Settlement risk may include credit and liquidity risk elements also.

Central securities depository function

In the case of the central securities depository, treasury transactions may have settlement risk involved, the central securities depository manages this risk with the settlement and pre-settlement limits set up in the limit system. Separate limit amounts are determined for Forint settlements and for FX settlements that represent increased risk.

KELER concludes proprietary trades in the OTC market only, the DVP principle is met when possible. Exceptions to this include FX trades with outer circle entities due to different Forint and FCY cut-offs.

The risks of the settlement system operated by the Group are managed under operational risks.

Central counterparty function

In line with the investment policy of KELER CCP, the amount of minimum capital requirement is invested in short-term government securities that are held until maturity. The portfolio includes a few securities; settlement risk upon trade settlement is negligible.

In the case of KELER CCP, no capital requirement is made for credit risk arising from settlement risk.

x. Concentration credit risk

Risk concentration is the risk exposure that intra-risk or inter-risk across various risk types can lead to loss that jeopardizes the business as usual operation (usual continuous operation with reasonable profits) of the entity or makes a material change in the risk profile of the entity.

Central securities depository function

Credit risk concentration towards individual clients and trade partners is a distribution of receivables when default by a group of relatively small number of clients/partners or by a larger group of clients/partners, attributable to common reason/reasons puts at risk the business as usual operation (usual continuous operation with reasonable profits) of the entity. The term "clients and trade partners" covers not only individual clients/partners, but also the groups of individual clients/partners that are closely connected (through ownership and/or funding). It has two major groups:

- concentration of risk taking to individual client/client group (large exposure): the source of risk is default on exposure to a relatively small group of clients or partners,
- sector concentration: risk of joint default due to common reason/reasons.

The risk management policy and the risk taking regulation of the central securities depository, approved by the Board of Directors, cover the management of concentration risks also.

Credit concentration risk can be identified on the asset side due to the high proportion of government bonds. However, it is not justified to determine concentration limit for exposures to the government and central banks.

With regard to the group of partners and activity restricted by legislation, the large exposure requirements under CRR are considered sufficient to measure and manage the counterparty risks at regulatory level. Concentration risks generated by interbank treasury trades are managed with the counterparty and counterparty group limits that are part of the internal treasury limit system.

Due to the holding in KELER CCP, KELER is indirectly involved in the concentration risks arising in the collateral portfolio of KELER CCP and related to the positions taken by the clearing members and energy market non-clearing members of KELER CCP. In the latter two instances, it is not KELER but KELER CCP as central counterparty where concentration risk arises and is managed.

The central securities depository does not make separate capital requirement for concentration risk.

Central counterparty function

Concentration risk related to the central counterparty activity of KELER CCP arises in two ways. On the one hand due to the concentration of positions taken by KELER CCP clearing members and energy market non-clearing members, on the other hand it is due to the concentration of collaterals on the other.

The market and capital position limit is designed to manage risk concentration related to counterparties towards which KELER CCP as central counterparty undertakes guarantee in exchange settlements. If these limits are exceeded, additional financial collateral can be collected in line with the General Business Rules of KELER CCP due to perceived risk increase to mitigate risks arising from increased concentration.

KELER CCP applies concentration limits in line with ESMA TS 153/2013, among others by individual issuer, asset type, to the concentration of securities in the central counterparty collateral portfolio.

KELER CCP does not make capital requirement for concentration risks.

xi. Country risk

Country risk is the risk of loss generated by an event (economic, political, etc.) occurring in the country, controllable by the country (government) given and uncontrollable by the partner of KELER.

Central securities depository function

KELER treats exposures to branches operating in Hungary as foreign risk exposure. The central securities depository applies conservative limits depending upon the external credit rating of the country and the amount of own funds. Additionally, positions in foreign currencies are monitored daily.

In line with the requirements of the ICAAP-ILAAP guidelines, no additional capital requirement is to be made due to country risk where the weight of risks towards the state is 0% or 20%. Based on the internal limits set up, the central securities depository can have risk taking only that does not result in the obligation to make capital requirement.

Central counterparty function

The country exposure of KELER CCP increases gradually due to the strategy followed as KELER CCP provides services to foreign counterparties and has multiple connections with international settlements. Some of the foreign counterparties are clearing members that are considered foreign legal entities as they transformed into branches, and for this reason the country risk of the parent company is to be taken into account also. Additionally, foreign clearing members/non-clearing members, partly related to the settlement of the MTS market, are also part of the KELER CCP counterparty group. Several energy market non-clearing members are registered abroad. Related to energy market clearing, KELER CCP has account management relationship with Citibank Frankfurt and clearing relationship with ECC, through this link KELER CCP is involved in foreign energy market clearing also.

In terms of country risk, the largest exposure is towards Germany due to the exposures to ECC and Citi Frankfurt. Germany is an EU member state and a superpower, with safe background. KELER CCP has no material exposure to non-EU member states currently and such exposure is not expected in the future either. Risks due to existing country risks are managed in the guarantee system.

KELER CCP does not make capital requirement for concentration risk.

<u>Market risk</u>

Market risk is the risk that the real value of the future cash flows of a financial instrument will be volatile due to changes in market prices. Market risk reflects the risks associated with interest-bearing assets, shares, indexes and, it may include foreign exchange risk and commodity risks as well.

i. Trading and non-trading book interest rate risk

Central securities depository function

KELER runs HUF interest rate risk and limited foreign exchange risk only.

In addition to yield optimization, the purpose of market risk management is to control market risk exposures within acceptable parameters.

KELER as central securities depository applies various limits to monitor market risks that are related to the following risk types: non-trading and trading book interest rate risk, FX rate risk, and full open FX position risk.

Market risk management involves daily measurement, monitoring, reporting on the one hand, and periodic stress tests on the other. In addition to the Asset-Liability Committee, Management (Management and Board of Directors) is informed regularly on market risks.

KELER manages separately the market risks arising in the trading and non-trading books.

The central securities depository kept its whole securities portfolio in the trading book. Trading activity involves making transactions in government debt securities.

The non-trading book portfolio typically included interbank trades and MNB loans/deposits and foreign currencies.
The following tables show the structure and changes in the trading and non-trading books as of 31 December 2016 and 31 December 2017, in HUF millions:

Trading book	**2017**	**2016**	**Change**
Discount treasury bills	28 774	48 010	(40,1%)
Government bonds	15 202	12 131	25,3%
Total	43 976	60 141	(26,9%)

Non-trading book	**2017**	**2016**	**Change**
Deposit With the central bank	10 755	17 349	(38,0%)
Interbank deposit	2 000	2 000	-
Total	12 755	19 349	(34,1%)

Capital requirement for trading book interest rate risk / position risk is determined in line with the maturity-based calculation standard methodology on regulatory level (general position risk, CRR Article 339). Capital requirement on ICAAP-ILAAP level is calculated with modified duration based interest rate sensitivity.

The central securities depository determines capital requirement for the interest rate risk of non-trading book items in line with ICAAP-ILAAP only, the methodology is identical to the ICAAP-ILAAP methodology of trading book capital requirement calculation.
The following tables illustrate changes in interest rate sensitivity of the trading and the non-trading books in 2016 and 2017, based on the last day of the month, in HUF millions:

Trading book	**2017**	**2016**
January	880,3	1 000,2
February	912,4	991,6
March	951,3	985,8
April	948,3	975,2
May	927,7	927,7
June	850,6	967,1
July	776,4	1 012,2
August	736,4	976,7
September	709,7	935,9
October	705,8	903,8
November	732,3	888,9
December	683,3	836,5

Non-trading book	**2017**	**2016**
January	16,6	26,6
February	7,0	15,5
March	19,7	6,5
April	13,7	16,4
May	12,6	12,7
June	19,7	11,6
July	11,7	19,8
August	7,1	10,4
September	7,9	11,9
October	3,8	11,5
November	0,4	17,1
December	1,4	26,4

In addition to daily capital requirements calculation, daily value at risk (VaR) for the trading and non-trading book portfolio is calculated daily. VaR calculation is based on 99% confidence level and 1 day relative change.
The following tables show VaR changes in 2016 and 2017, based on the last day of the month, in HUF millions:

Trading book	**2017**	**2016**
January	89,4	127,6
February	95,6	122,5
March	88,0	124,0
April	81,6	116,2
May	71,2	132,3
June	60,9	132,1
July	58,7	102,8
August	50,4	97,9
September	38,1	87,3
October	37,2	79,1
November	34,1	82,1
December	31,0	69,1

Non-trading book	**2016**	**2015**
January	5,9	15,6
February	3,2	8,2
March	5,4	4,2
April	5,3	5,4
May	3,3	6,4
June	5,3	5,5
July	4,2	7,2
August	1,6	4,4
September	0,,5	5,5
October	0,01	4,6
November	-0,017	3,6
December	-0,082	8,8

ii. Foreign exchange rate and exchange rate risk

Only the own FX positions (FCY account balances) represent FX risk for KELER, clients take the FX rate risk of foreign currency balances owned by clients and deposited in the accounts of the central securities depository. The primary purpose of foreign currency assets held by KELER is to make sure that the services provided by KELER CCP as central counterparty in the guaranteed markets and the international settlement services provided by KELER are secure and seamless and to ensure the related FX conversion service. The amount of the portfolio that can be held is limited in each currency, thus the amount of risk that can be taken is limited also. FX risk is measured with historic analyses and daily VaR calculation.

Changes in open own FX portfolio and calculated VaR changes in 2016 and 2017, on the last day of the month, in HUF million, are as follows:

	2017		**2016**	
Month	**Portfolio**	**VaR**	**Portfolio**	**VaR**
January	91,4	0,9	144,2	1,8
February	105,1	0,9	121,4	1,5
March	95,3	0,8	121,5	1,5
April	105,4	0,8	121,3	1,4
May	97,6	0,8	112,4	1,3
June	72,3	0,6	121,1	1,3
July	103,5	0,9	116,8	1,2
August	72,8	0,7	96,4	1,0
September	94,2	0,7	117,3	1,4
October	104,7	0,9	125,9	1,1
November	82,7	0,8	104,9	1,0
December	99,1	0,8	78,5	0,7

Central counterparty function

In the case of KELER CCP, there are several approaches to discuss market risk.
One approach is that related to the operation of the central counterparty a potential default can convert counterparty risk into market risk, upon default by the member concerned KELER CCP has to fund, temporarily or finally, cash/securities or derivative market variation margin with the sales proceeds of existing collaterals or with own resources if the former are not sufficient.
KELER CCP analyzes regularly the market risk of collaterals, i.e. the terms of eligibility: in line with the requirements of EMIR it analyzes monthly that the haircuts applied on eligible instruments are appropriate, if found inappropriate, haircuts are amended, and KELER CCP consults quarterly the Risk Committee on haircut levels. The group of eligible collaterals is in line with the requirements of EMIR.
Additionally, prudent margining is designed to cover the market risk of cleared instruments; the appropriateness of margining is monitored continuously.

Market risk can arise at KELER CCP as a part of own resources, that is the minimum capital requirement under EMIR (7.5 million EUR), is invested in Hungarian government securities, treasury bills that are held until maturity, thus market risk is not material related to these instruments.

As an ECC clearing member, KELER CCP provides guarantee undertaking to its non-clearing members in spot and futures energy market clearing. The entire amount of collective guarantee fund contribution payable to ECC is to be made in euro. Consequently, KELER CCP has a material FX portfolio that is the ECC guarantee fund contribution; however, it does not give rise to real FX rate risk in daily operation, it is not converted to HUF. The contribution to the ECC guarantee fund is deducted when the available capital is calculated.

KELER CCP does make capital requirement for market risk.

iii. Liquidity and funding risks

Central securities depository function

Liquidity is the ability of the entity to fund and meet the increase in assets, expiring liabilities without material unplanned risks. Based on the ICAAP-ILAAP manual liquidity risks can be put into two groups: liquidity and funding risks.

<u>Liquidity risk:</u> the risk that the entities are not able to meet financial liabilities on time within the day, operatively (30 days), in the short (1-3 months) and medium term (3-12 months) or due to related market liquidity risks they can sell balancing capacities at a material loss due to the inadequate depth of the market or other market disturbances. (Market liquidity risk is the risk that the entity is not able to realize positions at appropriate market prices, i.e. market liquidity risk is the risk that a market position cannot be closed at market prices during a short period of time, it can be closed at a worse price only, thus it is required to maintain the position to realize the appropriate market price, which may need depositing or taking liquid assets.)

<u>Funding risk:</u> the risk that in the long term, over the year, entities are not able to meet financial liabilities without unacceptable increase in funding costs. Thus, in the long term, entities cannot keep their funding stable.

The special activity of KELER, in particular seamless settlement requires liquid assets that can be mobilized quickly at all times. Partly due to the former requirement, the assets the central securities depository can keep are strictly regulated by legislation (see Article 46 of CSDR). In addition to legal restrictions, KELER endeavors to select financial instruments that can be sold quickly under normal market conditions if needed and can be used to create intra-day liquidity also. In terms of liquidity risk, the relationship with KELER CCP as central counterparty is of great importance, mainly due to the settlement loan service.

The liquidity risk limits determined by the central securities depository are monitored daily, capital requirement is determined on monthly basis. The Assets and Liabilities Committee discusses the reports. Additionally, a comprehensive report is prepared at least once a year for the KELER Board of Directors.

Central counterparty function

There are two major functions related to which KELER CCP needs liquidity: on the one hand liquidity is needed for guarantee undertaking, the main activity of KELER CCP - typically, KELER CCP is able to provide this liquidity with shareholder’s equity. On the other hand, a variable amount of liquid assets is required for the daily operation of

KELER CCP. One part of it is represented by the transfer price payable to KELER; the larger part consists of financial liabilities arising from ECC clearing membership. Liquidity needs related to guarantee undertaking may arise several times during a day, in line with market settlement times.

Regarding default related liquidity risk management, EMIR requires the capability to cover the liquidity need uncovered by individual collateral related to the two members with the largest exposures in the market.
The liquidity need expected on the following day and in some cases on later days is analyzed and forecast daily. It is assessed monthly, retrospectively, whether KELER CCP was able to meet the requirement of EMIR to cover the liquidity need arising from the risk of the two largest members uncovered by individual collateral.

KELER CCP does not create capital requirement for liquidity risk.

c) Operational risks

Operational risks are managed at Group level (KELER and KELER CCP joint regulation).
Operational risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risks (CRR, Article 4, section 52). Operational risk includes legal risk but does not include reputation and strategic risk (Based II, International Capital Framework, 2005.). According to the ICAAP-ILAAP manual, KELER examines and manages legal and reputational risk under operational risk.
Operational risk measurement and management under ICAAP-ILAAP is based on a Group-wide loss database that is supplemented by expert estimates and the collection of key risk indicators. All organizational units of the Group are to be involved in the collection of operational risk events, the regular assessment, evaluation and mitigation of risks. This way it can be ensured that the operational risk management system covers comprehensively KELER and KELER CCP that are intertwined in terms of operation and activity.
An operational risk management contact person is appointed in each Group unit; this person is responsible for forwarding to the operational risk management officer loss events that the contact person becomes aware of and the key risk indicators collected by its unit. In addition to the system of contact persons, there is an Operational Risk Committee (ORC) that meets regularly and decides on necessary action plans and monitors the implementation of measures earlier taken. The operational risk management officer reports to ORC quarterly.

In order to inform Management (Management, Board of Directors) continuously, the reports prepared for committee meetings and the minutes of the meetings that include the action plans also are to be sent to the Supervisory Boards of KELER and KELER CCP. The Boards of Directors of KELER and KELER CCP are provided thorough information annually on operational risks and their management.

Operational risks within the KELER Group are regularly identified and quantified based on the self-assessment interviews with the organizational units, Changes in operational risks are monitored through the regular collection of loss data. The regular analysis and reporting to Management of loss events ensures risk monitoring and is the basis of taking risk management measures.

The key risk indicator is an indicator moving parallel with operational risk losses that helps monitor changes in risk exposures. KRIs are collected to ensure the continuous monitoring of operational risks. KRIs are regularly assessed, the Operational Risk Committee continuously monitors KRIs and changes in KRIs over time, and it takes risk mitigation measures if needed.
The Group determines operational risk capital requirement at regulatory level based on the BIA model, in terms of internal approach, applies a risk sensitive model that is nearly AMA level.

d) General business risk

Central securities depository function
Pursuant to the provisions of Article 47 of CSDR, the central securities depository must cover general business risks with capital. The EBA RTS provides additional information in this regard that is in line with the requirements of the ICAAP-ILAAP manual. Because of its special position, KELER follows primarily the provisions of the CSDR to determine the capital requirement for general business risks, but at the same time it also takes into account the requirements set forth in the ICAAP-ILAAP manual when identifying applicable scenarios (standard scenario and at least 1 stress scenario). The specified capital requirement is intended to cover losses between normal and stress scenarios.

e) Winding-down or Restructuring Risk

Central securities depository function
Pursuant to Article 47 (2) of the CSDR, KELER must maintain a plan with respect to the following:

a. additional capital increase in case its equity capital approaches or falls below the requirements laid down by law;
b. ensuring the orderly winding-down or restructuring of its operations and services if KELER is unable to raise new capital.

With respect to raising additional capital, KELER's Recovery Plan contains the relevant provisions.

f) Capital management (Regulated institutions' capital management)

Central securities depository function
Besides acting as a central securities depository pursuant to the CSDR provisions, KELER provides non-banking and banking type ancillary services, therefore it shall comply with the applicable provisions of the Hungarian regulation (Tpt., Hpt. and ICAAP-ILAAP manual) and with the EU legislations (CRR) and guidelines related to the operation of credit institutions.

The central securities depository is required to comply with the own funds related requirements of CRR. The calculation of capital adequacy should be determined in accordance with Hungarian Accounting Rules available values.

The own funds of KELER consist of the following components:

- Tier 1 capital (T1):

  - Common Equity Tier 1 (CET1): subscribed capital, retained earnings, general reserves (based on regulation 10 % of profit for the period),
  - Additional Tier 1 (AT1): none,
- Tier 2 (T2): general risk reserve (additional reserves are not made), allocated reserves (currently none)

The negative elements of Common Equity Tier 1 are intangible assets, prudent valuation adjustment (as per Article 105 of CRR) and the total value of existing investments pursuant to Article 46 (4) of CSDR.

KELER does not apply Group level capital adequacy.

The following chart shows the calculation of central securities depository own funds and capital adequacy ratio as of 31 December:

	2017	**2016**
Subscribed capital	4 500	4 500
Retained earnings	21 839	20 566
Profit for the period	(219)	1 270
General reserves	0	2 473
Tier 1, total	**26 120**	**28 809**
General risk reserves	111	99
Tier 2, total	**111**	**99**
Deductions(-)		
Intangible assets	(520)	(2 877)
Limit excess due to investment restrictions	0	0
Value adjustments due to the requirements for prudent valuation	(130)	(213)
Limit excess due to large exposure taking restrictions	0	0
Holding in KELER CCP	(4 545)	(4 545)
Tota deductions	**(5 195)**	**(7 635)**
OWN FUNDS	21 036	21 273

Capital adequacy ratio	**2017**	**2016**
CET1 Capital Adequacy Ratio	24,34%	42,54%
Total Capital Adequacy Ratio	24,47%	42,74%

The minimum level of capital adequacy expected by the applicable regulations has been increasing gradually since 2016; however, in light of the current capital position of KELER, no additional intervention is needed.

Based on the capital requirements of the central securities depository calculated for regulatory risks and risks defined by ICAAP-ILAAP, Risk Management at KELER CCP determines for each day the capital to be created and checks that own funds are sufficient.

The following table details the calculation methodology applied for regulatory and internal capital requirement for certain risk types:

Risk	Regulatory	ICAAP-ILAAP
Credit and counterparty risks	Standard method	Based on own weights, similarly to the regulatory method
Intra-day credit risk	Based on article 8 of EBA RTS	Based on own weights, similarly to the regulatory method
Risk of default exposures	Based on article 127 of CRR	Based on the ICAAP-ILAAP manual (risky portfolios)
Off-balance sheet items	Based on article 111 of CRR	Based on own weights, similarly to the regulatory method
International settlement credit risk	-	Based on historical data
Position risk/Trading book interest rate risk	Position risk: maturity based approach	Based on interest rate sensitivity
FX exchange rate risk	8% of the total net position of foreign currencies owned, if the net open position reaches 2% of own funds.	Supervisory Var model
Liquidity and financing risk	-	The sum of the liquidation cost of the securities portfolio calculated on a 6 month GARCH basis weighting
Operational risk	BIA method	Based on actual losses, theoretical events and scenario results, with Monte Carlo simulation and with VaR
General business risk	Based on article 6 of EBA RTS	Equivalent to the regulatory method
Winding-down or restructuring risk	based on article 7 of EBA RTS	Equivalent to the regulatory method

KELER created the following capital requirements on 31st December 2016 and 31st December 2017[5]:

2017

Risk	Capital requirement, regulatory (CSDR+CRR)	Capital requirement, internal (ICAAP-ILAAP)
Position risk/Trading book interest rate risk	482	1 367
Credit and counterparty risks[6]	751	778
FX rate risk	-	27
Operational risk	938	560
Non-trading book interest rate risk	-	3
Liquidity and financing risk	-	12
General business risk	973	973
International settlement credit risk	2 270	2 270
Winding-down or restructuring risk	-	509
Total	**5 414**	**6 499**

2016

Risk	Capital requirement, regulatory (CSDR+CRR)	Capital requirement, internal (ICAAP-ILAAP)
Position risk/Trading book interest rate risk	601	1 673
Credit and counterparty risks	701	606
FX rate risk	-	21
Operational risk	938	734
Non-trading book interest rate risk	-	52
Liquidity and financing risk	-	9
General business risk	-	183
International settlement credit risk	-	405
Winding-down or restructuring risk	-	-
Total	**2 240**	**3 683**

For each risk the higher of the regulatory and internal capital requirement is to be made. In line with the above rule, the final capital requirement to be made based on 31 December 2016 data would be HUF 3.982 million, while the actual capital requirement to be made as of 31 December 2017 would be HUF 6.877 million.

Central counterparty function

KELER CCP is not a credit institution; the Basel requirements, the CRR or the CRD do not apply directly to KELER CCP. However, the requirements of EMIR cover the

[5] Not audited data
[6] Total without international settlement credit risk

capital requirements of CCPs also. Central counterparties are required to have shareholders' equity of at least 7.5 million Euros on a permanent basis (Capital requirement II) and the amount of shareholders' equity is required to be proportionate to the risk arising from the central counterparty activity. The ESMA technical standard details the calculation method of capital requirement.

KELER CCP is required to determine the amount of capital requirement for the following risks (Capital requirement I):

1. capital requirement on credit and counterparty risks,
2. capital requirement on operational and legal risks;
3. capital requirement on market risks (FX rate and securities position risk),
4. capital requirement on winding up or restructuring of the activity of the central counterparty,
5. capital requirement on business risk

Determination of available solvency capital

The amount of available capital equals the components of shareholders' equity:

- subscribed capital
- issued but not paid capital (-)
- capital reserves
- retained earnings
- allocated reserves
- revaluation reserve
- retained earnings of the year

And the following items are to be deducted from this:

- Intangible assets
- contribution to the guarantee fund of other CCPs (ECC Euro guarantee fund contribution)
- contribution to own guarantee fund

The available capital is required to cover the following elements:

- Minimum capital requirement
- Dedicated own resources = (0,25 * MAX (Capital requirement I., Capital requirement II.)
- Other financial resources (remaining amount after deduction of the above two items)

The following table shows KELER CCP capital adequacy at the end of 2016 and 2017:

	2017	**2016**
Available capital	4 117	4 550
Minimum capital requirement	2 559	2 566
Dedicated own resources	582	583
Other financial resources	977	1 401

NOTE 5: CASH AND CASH EQUIVALENTS

	31.12.2017	**31.12.2016**
Due from banks and balances with CBH		
Within one year		
In HUF	11 013	17 395
In foreign currency	11 006	2 782
Cash equivalents	2 545	11 724
Closing balance	24 564	31 901

The cash equivalents include treasury bills issued by the Hungarian State that has the maturity of less than three months when acquired. These are highly liquid financial assets subject to insignificant risk of value change. The cash equivalents are stated at amortised cost.

	31.12.2017	**31.12.2016**
Placements with other banks		
Within one year		
In HUF	2 209	2 080
In foreign currency	39 091	19 152
Closing balance	41 300	21 232

The bank accounts are demand deposits, available immediately for withdrawal. The interest on the bank account is between (-0,05%) to (-0,15%) for HUF deposits. These expenses are recorded as interest paid in the statement of incomes. For the 3 month deposits – available only until September 2017 – the rate was between 0,9%.

Designated deposit

The designated deposit balance includes HUF deposits that are received from the clients as contribution to the Guarantee funds (see Note 16). These cash balances may only be used for certain purposes, strictly regulated by EMIR (such as day-end repos). These cash balances are included in the above figures.

Based on the requirements for compulsory reserves set by the CBH, the balance of compulsory reserves amounted to approximately HUF 531,5 and HUF 1 903 million on average in 2017 and 2016, respectively. This compulsory reserves are kept on the deposit with CBH due within one year.

Daily balance of interbank statements was HUF 203,5 million and HUF 79 751 million as at 31 December 2017 and 2016, respectively.(The reason for the material change is that in 2017 the so called 3-months deposit by CBH is not available anymore. At the end of 2016, a material balance was kept in the foresaid investment possibility.)

Interbank placements include bank accounts at Clearstream Bank, SIX SIS, Citibank A.G., Citibank NY, Citibank London, CBH, OTP Bank Plc. and MKB Bank Plc.

NOTE 6: AVAILABLE FOR SALE FINANCIAL ASSETS

	31.12.2017	31.12.2016
Available for sale financial instruments		
Treasury Bills issued by the Hungarian State	35 408	39 045
Government Bonds issued by the Hungarian State	15 162	14 074
	50 570	53 119

	2017	2016
Available for sale financial instruments		
Treasury Bills issued by the Hungarian State		
Opening Balance	39 045	58 044
Acquisition	35 380	38 778
Derecognition (selling, maturity)	(39 045)	(58 044)
Interest accrued (Amortisation)	19	150
Remeasurement (Fair Value Adjustment)	9	117
Closing balance on 31 December	35 408	39 045

	2017	2016
Available for sale financial instruments		
Government Bonds issued by the Hungarian State		
Opening Balance	14 074	16 341
Acquisition	3 953	3 932
Derecognition (selling, maturity)	(2 815)	(6 071)
Interest accrued (Amortisation)	(13)	(73)
Remeasurement (Fair Value Measurement)	(37)	(56)
Closing balance on 31 December	15 162	14 074

The interest of the AFS instruments was taken to the Consolidated Statement of Comprehensive Income using the effective interest method, and the changes in the fair value from the recognition date until the end of the reporting period was recognized as other comprehensive income (OCI). This OCI will be reclassified to the profit or loss when the underlying financial asset is derecognized.

The fair value of these assets can be determined based on readily available quoted prices published by Hungarian Debt Agency (Level 1). However, when the fair value of these assets cannot be determined based on such quoted prices, instrument are measured based on yields remarkable for similar financial instruments and generally used valuation techniques (Level 2).

NOTE 7: TRADE RECEIVABLES AND TRADE PAYABLE RELATING TO GAS MARKET

Accounting policies relating to the trading on the gas market is explained in Note 3. This balance relates to receivables from the participants on the foresaid gas market. These are paid – according to the contract – in less 30 than days. These balances are neither impaired nor past due. The collateral behind the receivable guarantees that the chance of any type of uncollectability is far beyond remote.

The balance of this receivable depend on the trading activity on the market that the entity does not influence.

The liabilities from the gas market are they payable amount that is the other “party” of the clearing transaction. The payables are – by contractual agreement – due on the same day as the corresponding receivable.

The fair value of these receivables and payables are close to their book value (the payment is done in a short time and no other issues require adjustment).

NOTE 8: TRADE RECEIVABLES FROM CENTRAL COUNTERPARTY AND DEPOSITORY OPERATION

Receivables relating to clearing and depository activities	**31.12.2017**	**31.12.2016**
Receivable balance	702	548
Accumulated impairment losses	(40)	(38)
Receivable balance net of impairment (carrying amount)	662	510

Accumulated impairment losses of trade receivables	**2017**	**2016**
Opening accumulated impairment losses	(38)	(39)
Impairment losses recognized in the current period	(10)	(7)
Impairment losses derecognized in the current period	8	8
Closing accumulated impairment losses	(40)	(38)

These trade receivables include the not yet paid part of the rendered CCP, Depository and similar services. The balances are stated at invoiced amounts since they become payable in a short time.

The impairment loss of the receivables is assessed individually due to the low number of the partners and the materiality of the individual balances. The entity calculates the loss based on an aging analysis, but on individual level. This analysis builds on historical evidence and updated frequently.

The derecognized impairment loss is due to the recovery of receivables that were previously identified as impaired and impairment loss was recognized.

The impairment loss or gain of the reversal is reported on a separate line in Consolidated Statement of Comprehensive Income, on a net basis.

The fair value of these receivables do not show significant difference from the amortized cost as carrying amounts, thus carrying amount shows the best estimation of the fair value.

NOTE 9: OTHER RECEIVABLES, TAX RECEIVABLE

	31.12.2017	**31.12.2016**
Other receivables		
Prepaid expenses	267	146
Tax receivables (other than income taxes)	485	153
Sundry other receivables	88	84
	840	383

The other tax receivables consist of the following balances:

	31.12.2017	**31.12.2016**
Tax receivables (other than income taxes)		
Value added tax	474	133
Personal income tax	-	4
Social security contributions	8	14
Other taxes	3	2
	485	153

All tax balances are related to the Hungarian Tax Authority.

The income tax receivable is disclosed on a separate line in Consolidated Statement of Financial Position (2017: 219 MHUF, 2016: 115 MHUF). The Group considers corporate income tax and for KELER Depository Ltd. local tax and innovation contribution to be income tax for accounting purposes.

These receivables do not yield interest and they are all to be received within one year. They are not impaired nor past due. The fair value of these receivables is the same with the book value.

NOTE 10: RECEIVABLES FROM CLEARING HOUSES

KELER CCP as a general clearing member of the ECC is entitled to provide power market non-clearing membership services from 1 July 2010 on the spot power market, and 1 July 2011 on the futures power market. According to the GCM status clearing members have to comply with specified margin and collective guarantee requirements of ECC. During 2013 ECC introduced the daily spot margining system and a new margin calculation method which resulted a relatively high amount of margin call towards KELER CCP.

The receivable is denominated in euro. In the original currency the receivable from power market is: 40.036.633 EUR on 31 December 2017 (25.483.295 EUR on 31 December 2016).

Based on impairment test performed to these financial instruments, there are no objective evidence that financial assets are impaired, thus no provision for impairment losses is recognized in the consolidated financial statements.

The fair value of these receivables do not show significant difference from the amortized cost as carrying amounts, thus carrying amount shows the best estimation of the fair value.

NOTE 11: INTANGIBLE ASSETS

As at and for the period ended 31 December 2017

Intangible assets	Rights	Intellectual property	Total
Cost			
Balance as on 1 January 2017	171	10 624	10 795
Additions	-	1 008	1 008
Disposals	-	-	-
Partial disposal	-	-	-
Balance as on 31 December 2017	171	11 632	11 803
Cumulated Depreciation and Amortization			
Balance as on 1 January 2017	151	7 193	7 344
Additions	-	332	332
Disposals	-	-	-
Impairment of intangible assets	-	3 342	3 342
Balance as on 31 December 2017	151	10 868	11 019
Net book value			
Balance as on 1 January 2017	20	3 431	3 451
Balance as on 31 December 2017	20	764	784

As at and for the period ended 31 December 2016

Intangible assets	Rights	Intellectual property	Total
Cost			
Balance as on 1 January 2016	175	9 190	9 365
Additions	0	1 428	1 428
Disposals	0	6	6
Partial disposal	(4)	0	(4)
Balance as on 31 December 2016	171	10 624	10 795
Cumulated Depreciation and Amortization			
Balance as on 1 January 2016	151	6 779	6 930
Additions	0	414	414
Disposals	0	0	0
Balance as on 31 December 2016	151	7 193	7 344
Net book value			
Balance as on 1 January 2016	24	2 411	2 435
Balance as on 31 December 2016	20	3 431	3 451

Performance of the impairment review test - Rights

Rights include a customer list acquired (purchased) by KELER CCP in 2015 (cost: 24 MHUF). This is considered to be having an indefinite useful life. A part of the foresaid intangible asset was derecognized in 2016, since a customer – acquired through this list – left the operation. The value of the amount to be derecognized was calculated based on revenue share. in 2017, there was no similar partial derecognition, the net asset value is stated at 20MHUF. Based on the results of impairment review test to this asset, no such circumstances have been identified which refer to impairment loss.

Performance of the impairment review test – Intellectual properties

Intellectual properties include mainly software products of the Group.

<u>Software products under development</u>
The Group is in the process of developing a new software as intellectual property to support its daily operation. This development process was started still in 2013. The impairment review test of the software products related to this not yet completed development in the previous years did not result in the recognition of an impairment loss. However, the impairment review test completed in 2017 resulted a recoverable amount that is lower than the current carrying amount of these intangible assets. The background of the result of impairment review test was that the project materially prolonged and the expected positive results from the new system became uncertain – this uncertainty being material. The planned development would expected to lead to a more modern, up-to-date system, and to new services.
Given the fact that the 'go live date' has been postponed and remains uncertain, the Group needs to find an alternative solution in order to meet its own needs and those of its customers.
The Group concluded that the recognition criteria for an internally generated intangible asset will be not met in a foresee-able future, therefore the asset needed to be impaired (written down) and the resulting amount expensed in the profit or loss as an impairment loss.

At the same time a formal impairment review was also conducted resulted a recoverable amount of the development being zero.

Summarization of impairment test	
Carrying amount of intangible assets (not yet completed)	3 342
Recoverable amount	-
Impairment loss recognized in the period	(3 342)

<u>Other software products</u>
Based on the results of impairment review test to intangible assets other than assets related to development process described above, no such circumstances have been identified which refer to impairment loss.

NOTE 12: PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment **Cost**	**Buildings and improvements**	**Machinery and equipments**	**Total**
Balance as on 1 January 2017	158	1 805	1 963
Additions	-	94	94
Disposal	23	88	111
Balance as on 31 December 2017	135	1 811	1 946
Cumulated Depreciation and Amortization			
Balance as on 1 January 2017	88	1 464	1 552
Additions	59	130	189
Disposal	58	23	81
Balance as on 31 December 2017	89	1 571	1 660
Net book value			
Balance as on 1 January 2017	70	341	411
Balance as on 31 December 2017	46	240	286

Property, plant and equipment **Cost**	**Buildings and improvements**	**Machinery and equipments**	**Total**
Balance as on 1 January 2016	155	1 791	1 946
Purchases	3	77	80
Sale	0	63	63
Balance as on 31 December 2016	158	1 805	1 963
Cumulated Depreciation and Amortization			
Balance as on 1 January 2016	71	1 385	1 456
Purchases	17	136	153
Sale	0	57	57
Balance as on 31 December 2016	88	1 464	1 552
Net book value			
Balance as on 1 January 2016	84	406	490
Balance as on 31 December 2016	70	341	411

The above items contribute to the business activity. The buildings and improvements include improvements on leasehold property (the headquarter office of Group). These improvement include incentives received from the lessor (original value: 33 MHUF). The lessor – in order to encourage the entry in the lease agreement – purchased certain items for the Group. These items may only be used by the Group (they are built in the leased property). As the Group concluded that these assets are controlled by them they recognized them as non current asset. The income relating to this is deferred. The deferred income is released in line with the deprecation charged for these received assets.

The majority of the machinery and equipment are computers, servers and similar IT equipment that is customized for the activity of the Group. A smaller portion of this position is fixtures and fittings for the administrative activity.

Currently there are no commitment to purchase tangible assets. There are no pledges or similar items limiting the transfer or use of these assets.

The depreciation is charged to the Consolidated Statement of Comprehensive Income.

NOTE 13: TRADE PAYABLE

Payables from other activities that are not classified to other positions are under trade payables. These amounts are usually due within 60 days. The trade payables are mainly denominated in HUF and in EUR.

NOTE 14: OTHER PAYABLES

	31.12.2017	31.12.2016
Other payables		
Accrued expenses	428	359
Other Taxes payable	91	71
Sundry other liabilities	150	137
Financial guarantee contract	4	4
	673	571

The accrued expenses consist of sundry expenses that relate to this period but they were not yet invoiced, incurred. The liabilities due to discounts include items that were granted to clients based on their activity in the previous periods. These discounts are calculated at the end of the period and deducted from the revenues.

The balance of this liability includes a financial guarantee contract liability due to the central counterparty activity of the Group. The nature of the activity of the Group requires to cover all the risk that are coming from default events (i.e. that the central counterparty must settle the compensation of the transaction even if one of the parties of the clearing agreement is unable to pay/act). To ensure the source of these payments the entity operates guarantee system with several funds collected from the participants of the markets. These funds are based on calculations which are not designed to provide full coverage (i.e. it is impossible to provide 100% guarantee). Starting from 2015 the entity decided to set up a separate liability to reflect this. To deal with the statistically uncovered exposure the entity recognizes a financial guarantee contract liability based on the available collateral and the probability of a loss event regardless how small this probability is. The changes in the FGC balance is fully explained by the movements of the guarantee funds.

NOTE 15: DEPOSITS FROM CUSTOMERS, FINANCIAL GUARANTEE CONTRACT

	31.12.2017	31.12.2016
Deposits from customers		
Interest-bearing		
Within one year		
In HUF	34 286	52 234
In foreign currency	23 323	9 403
Non interest-bearing		
Within one year		
In HUF	50	100
In foreign currency	38 724	18 905
	96 383	80 642
Accrued interest payable	5	13
	96 388	80 655

These balances include the deposits of the customers. These balance are available for the customers for immediate withdrawal.

The deposits are stated at amortized cost (the fair value of these liabilities are close to their book value).

The Group paid an annual average rate of -0,1% in year 2017 and 0,27% 2016 for the HUF interest-bearing deposits. In 2017 and 2016, the Group did not pay interests for the foreign exchange deposits, or the deposited amount received negative interest.

NOTE 16: GUARANTEE FUND LIABILITIES

	31.12.2017	31.12.2016
Liabilities for Guarantee Funds		
Exchange Settlement Fund	1 571	2 625
Collective Guarantee Fund	2 924	1 688
Gas Market Collective Guarantee Fund	1 002	1 022
CEEGEX Market Collective Guarantee Fund	351	110
Less: own contribution	(20)	(20)
	5 828	5 425

As an element of the guarantee system, KELER CCP operates several collective guarantee funds. The purpose of the guarantee fund is to reduce the risk arising from default or failure of cleared and guaranteed transactions made by the Clearing Members. Contributions of the Members are kept in cash on 31 December.

The amount of the above contributions depends on the member's activity on the given market. Therefore these amounts are changing frequently.

The collected amounts are subject to interest. Interest is paid on a regular basis. These liabilities are recognized at amortized cost which is equal to their fair value.

Since the Entity itself transacts on the above markets, it must have contributed to these funds. The own contribution for this fund was removed from the liability and on the other hand no receivable were recognized (the positions were netted).

The changes in the FGC is recognized in the Consolidated Statement of Comprehensive Income. The fair value of the FGC was arrived to by using the collateral's fair value, adjusted with haircut, taking into consideration the not yet covered risks.

NOTE 17: DEFERRED TAXES, RECONCILIATION OF THEORETICAL AND ACTUAL TAX

When calculating deferred taxes, the entity compares the amounts to be considered for taxation purposes with the carrying value for each asset and liability. If the difference is reversible (i.e. the difference is equalized in the foreseeable future), then a deferred tax liability or asset is recorded in a positive or negative amount as appropriate. Recoverability was separately examined by the entity when recording each asset.

When computing taxes, the entity used a 9% rate upon reversal.

Deferred tax assets are supported by a tax strategy which confirms that the asset is expected to be recovered based on the information available.

The change in deferred taxes was recognized in the profit or loss and for the available for sale financial instruments in the other comprehensive income.

The tax balances and temporary differences for 2017 are as follows:

Balance	Tax base	Carrying Amount	Deductible, taxable difference	Deferred tax through profit or loss	Deferred tax through OCI
Cash and cash equivalents(*)	63 661	66 207	2 545	-	(229)
Trade receivables	5 049	5 049	-	-	-
Other receivables	14 716	14 716	-	-	-
Available for sale financial assets	58 062	57 238	(826)	(106)	180
Property, plant and equipment	191	288	95	(9)	-
Intangible assets	4 103	1 162	(2 940)	32	-
Trade payables	4 582	4 582	-	-	-
Accruals and other liabilities	110 663	110 721	(58)	5	-
General risk reserve	122	907	(786)	71	-
Financial guarantee contract liability	-	5	(5)	-	-
			Deferred tax assets	3	-
			Deferred tax liability	(8)	(49)

(*) including government treasury bills maturing within 90 days (counted from the date of purchase).

The tax balances and temporary differences for 2016 are as follows:

Balance	Tax base	Carrying Amount	Deductible, taxable difference	Deferred tax through profit or loss	Deferred tax through OCI
Cash and cash equivalents	60,033	60,033	-	-	-
Trade receivables	4,263	4,259	(4)	-	-
Other receivables	8,489	8,489	-	-	-
Available for sale financial assets	51,257	53,114	1,857	(127)	(40)
Property, plant and equipment	209	412	203	(18)	-
Intangible assets	3,502	3,830	328	(30)	-
Trade payables	4,125	4,125	-	-	-
Accruals and other liabilities	93,544	93,588	(44)	4	-
General risk reserve	122	-	122	(11)	-
Financial guarantee contract liability	-	4	(4)	-	-
			Deferred tax assets	2	-
			Deferred tax liability	(184)	(40)

Deferred tax balances are not discounted.

The effect of the change in the tax rate is 9%, all periods presented.
The entity will start to use IFRS in the separate financial statements starting from the financial year 2018. The Group is required to prepare the separate financial statements of both entities in the Group under IFRS. The transition will require the entities to reassess the tax base of the assets and liabilities of the companies, since before 2018 all calculation was derived from the net asset values under the Hungarian rules.

On transition to reporting under IFRS the group assesses the differences from tax prespective and differences arising from the two system influencing tax will be considered for taxation.

The Entity has a choice: all taxable/deductible differences identified are calculated and recorded on transition (1st January 2018) or only differences arising from items other than intangible asset and property plant and equipment is taxed.

The Group decided that all taxable/deductible differences are considered immediately on transition. The effect of this tax is going to be recognized in 2018 and if positive the entities may, if negative the entities must settle/recover them in three years. The adjustments are going to be presented in the tax return prepared for the fiscal year 2018, filed until 31st May 2019.

The current assessment shows that the following items will lead to tax effective differences.

The difference between the theoretical and effective tax is coming from the following reasons. This reconciliation only includes corporate income tax (in local tax there is no adjustments needed to arrive to the tax base).

	2017	**2016**
Profit before taxes	(2 900)	1 928
Tax rate	9%	17%
Theoretical tax	**(261)**	**321**
Departures from theoretical tax:		
Different treatment of non current assets (depreciation)	5	12
Non tax deductible expenses (permanent)	1	-
Adjustment for different tax rates	-	(14)
Non tax deductible impairment losses (timing difference)	262	-
Non tax deductible provisions (timing difference)	71	-
Effects of different accounting frameworks	47	(6)
Effective current tax	**125**	**314**

The tax rate in 2016 was calculated as an average, since two tax rates were in effect depending on the taxable profit (10% until 500 mHUF, 19 over 500 mHUF). In 2017 the legislation only included one tax rate (9%).

Due to the fact that the taxation in 2016 and 2017 is based on the Hungarian accounting regulation the effective tax is adjusted with the effect of the differences between the legislations. Furthermore the tax base was adjusted by the non-tax deductible items and those which result in a timing difference. The table above includes tax effects (and not tax base effects).

NOTE 18: SHARE CAPITAL

There was no change in the share capital of the Company compared to the prior year. The share capital consists of 900 shares with nominal (par) value of HUF 5 million per share as on 31 December 2017. All 900 shares have been authorized, issued and fully paid.

	31.12.2017	**31.12.2016**
Share capital		
Magyar Nemzeti Bank (Central Bank of Hungary)	2 400	2 400
Budapesti Értéktőzsde (Budapest Stock Exchange)	2 100	2 100
	4 500	4 500

There are no special rights or limitations attributed to shareholders by these shares.

Magyar Nemzeti Bank (Central Bank of Hungary) held 53.33% of the shares directly and 37,96% indirectly as of 31 December 2017 (3.24% as of 31 December 2016).

Budapesti Értéktőzsde (Budapest Stock Exchange) held 46.67% of the shares directly as on 31 December 2017 and 31 December 2016. However BSE’s majority stake (81,35%) was acquired by CBH during this reporting period in 2016 (remains unchanged).

Non-controlling interest represents the 0.02% share of non controlling shareholders of BSE in KELER CCP (all presented periods).

NOTE 19: STATUTORY RESERVES

	31.12.2017	**31.12.2016**
Statutory Reserves		
General reserve	-	2 474
General risk reserve	122	122
	122	2 596

These reserves are recognised due to legislative requirements. Certain regulation requires the Parent Company to transfer from earnings certain amounts to these reserves, so they will not be available for distribution, but only for the cover of operating losses.

General reserve
The amount of general reserve is 10% of annual income after tax (calculation is made in unconsolidated financial statements in accordance with Hungarian Accounting Standards). This reserve can be used only to cover losses from operations.

General risk reserve
The general risk reserve (that formerly calculated based on income before tax) cannot be recorded any more due to changes in regulations. The remaining balance can be transferred to profit reserve when it is used.

Accumulated translation difference

The retranslation of the foreign activity (the Luxembourg subsidiary) was done using the closing rate method. The difference arising on the retranslation was accumulated in a separate reserve in equity. The subsidiary's voluntary liquidation was finalized in 2017, so all accumulated translation difference was recognized in the profit or loss in this period. This reclassification was done trough the other comprehensive income.

Available for sale revaluation reserve

The revaluation reserve includes the effect of the remeasurement of the AFS items. This reserve is recycled into the net income when the underlying asset is derecognized. In the current period 22 MHUF gain was reclassified to profit or loss due to disposal of the underlying asset (pervious year: 1 MHUF loss).
No temporary impairment losses were recognized in other comprehensive income.
The deferred tax effect of this remeasurement is also accumulated in this reserve.

NOTE 20: STATEMENT OF FINANCIAL POSITION CATEGORIES BASED ON CURRENT-NON CURRENT DISTINCTION

The Entity presents it's Consolidated Statement of Financial Position in liquidity order. The reason for that is that the KELER is a financial institution and as such it is usual to follow this order. The Consolidated Statement of Financial Position based on the current – non current distinction is the following.

	31.12.2017	**31.12.2016**
Non current assets	1 073	3 864
Current assets	135 885	118 668
Short term liabilities	107 942	90 465
	29 016	32 067
Financed by:		
Long term liabilities	120	271
Owners' equity (net assets)	28 896	31 796
	29 016	32 067

The non current assets include the intangible assets, the property plant and equipment and the deferred tax asset.
The long term liabilities include certain employee benefits and the financial guarantee contract liability.

All other items of the Consolidated Statement of Financial Position are current. The Group defines an item of the Consolidated Statement of Financial Position being current if the due date is within 12 months.

Maturity analysis of assets and liabilities

The Group prepares a maturity analysis to present when the assets and liabilities of the entity are/becoming due. This analysis presents the surplus or deficit in items available for settlement. The main considerations on liquidity risk is presented in Note 4.

As on 31 December 2017	Within 3 months	Within one year and over 3 months	Within 5 years and over one year	Over 5 years	Without maturity	Total
Cash and cash equivalents	24 564	-	-	-	-	**24 564**
Placements with other banks	41 300	-	-	-	-	**41 300**
Available for sale financial assets	13 129	22 490	10 129	4 822	-	**50 570**
Income tax receivable	-	219	-	-	-	**219**
Income tax receivable	3	-	-	-	-	**3**
Trade receivables relating to gas market	4 135	-	-	-	-	**4 135**
Receivables relating to clearing and depository activities	662	-	-	-	-	**662**
Receivables from foreign clearing houses	13 595	-	-	-	-	**13 595**
Other receivables	825	2	10	3	-	**840**
Intangible assets	-	-	-	-	784	**784**
Property, plant and equipment	-	-	-	-	286	**286**
TOTAL ASSETS	**98 213**	**22 711**	**10 139**	**4 825**	**1 070**	**136 958**
Deposits from customers	96 388	-	-	-	-	**96 388**
Liabilities for Guarantee Funds	5 828	-	-	-	-	**5 828**
Income tax payable	-	-	-	-	-	**-**
Deferred tax liability	-	57	-	-	-	**57**
Trade payable from gas market activity	4 106	-	-	-	-	**4 106**
Trade payables	224	-	-	-	-	**224**
Provisions for onerous contract	786	-	-	-	-	**786**
Other payables	610	-	-	63	-	**673**
TOTAL LIABILITIES	**107 942**	**57**	**-**	**63**	**-**	**108 062**
LIQUIDITY (DEFICIENCY)/EXCESS	**(9 729)**	**22 654**	**10 139**	**4 762**	**1 070**	**28 896**

As on 31 December 2016	Within 3 months	Within one year and over 3 months	Within 5 years and over one year	Over 5 years	Without maturity	Total
Cash and cash equivalents	31 901	-	-	-	-	**31 901**
Placements with other banks	21 232	-	-	-	-	**21 232**
Available for sale financial assets	2 500	36 546	7 595	6 478	-	**53 119**
Current tax receivable	-	115	-	-	-	**115**
Deferred tax receivable	2	-	-	-	-	**2**
Trade receivables relating to gas market	3 482	-	-	-	-	**3 482**
Receivables relating to clearing and depository activities	510	-	-	-	-	**510**
Receivables from foreign clearing houses	7 926	-	-	-	-	**7 926**
Other receivables	368	2	10	3	-	**383**
Intangible assets	-	-	-	-	3 451	**3 451**
Property, plant and equipment	-	-	-	-	411	**411**
TOTAL ASSETS	**67 921**	**36 663**	**7 605**	**6 481**	**3 862**	**122 532**
Deposits from customers	80 655	-	-	-	-	**80 655**
Liabilities for Guarantee Funds	5 425	-	-	-	-	**5 425**
Income tax payable	-	-	-	-	-	**-**
Deferred tax liability	-	223	-	-	-	**223**
Trade payable from gas market activity	3 500	-	-	-	-	**3 500**
Trade payables	362	-	-	-	-	**362**
Other payables	523	-	-	48	-	**571**
TOTAL LIABILITIES	**90 465**	**223**	**-**	**48**	**-**	**90 736**
LIQUIDITY (DEFICIENCY)/EXCESS	**(22 544)**	**36 440**	**7 605**	**6 433**	**3 862**	**31 796**

When the maturity of an item is not determinable the group classifies the asset as being without a maturity, the liability to the within 3 months category.

NOTE 21: INCOME FROM CLEARING AND DEPOSITORY ACTIVITY

Income from clearing and depository activity	**2017**	**2016**
Clearing and depository fees	2 871	2 618
Other commission income	705	674
Transaction fees	1 309	1 221
Security transaction fees	759	769
Account maintenance fees	106	107
	5 750	5 389

One of the main revenue generating activity of the Group is the fee income from acting as a central counterparty on several markets and as central depository. These revenues are allocated to the period when the service is provided.

NOTE 22: NET INTEREST INCOME

	2017	**2016**
Interest income:		
Loans	34	55
Due from banks and balances with the National Bank of Hungary and other banks	248	388
Held for trading securities	790	1 371
	1 072	**1 814**
Interest expense:		
Due to banks and deposits from the National Bank of Hungary and other banks	(108)	(125)
Deposits from customers	(55)	(311)
	(163)	**(436)**
NET INTEREST INCOME	**909**	**1 378**

The other revenue generating activity of the Group is – as a financial institution – to hold free financial assets to gain from net interest. The deposits of the clients are placed on the market to reach maximum yield. Gain from this activity is calculated on net basis.

NOTE 23: GAINS AND LOSSES FROM TRADING WITH SECURITIES

This line in the Consolidated Statement of Comprehensive Income includes the realized gains and losses from trading of treasury bills and government bonds. The revaluation gains and losses of treasury bills and government bonds are taken to the other comprehensive income and reclassified to profit or loss upon realization. Both instruments are classified as available for sale. No other instruments resulted in gains or losses from trading.

NOTE 24: BANK FEES, COMISSION AND SIMILAR ITEMS

This position fees, commissions charged by other financial institutions and the stock exchange for the activities of the entity.

NOTE 25: PERSONNEL EXPENSES

		2017		2016
Personnel expenses				
Wages		1 687		1 497
Base wages	1 505		1 209	
Bonuses	182		288	
Social security and other contributions		452		468
Other cost of personnel		284		245
		2 423		2 210

All the personal expenses are relating to short term employee benefits – including accumulating paid leaves – except the jubilee bonuses 52 in 2017 (41 in 2016) which is a long term employee benefit.

The average number of employees was 169 in the period ended 31 December 2017 (2016: 154).

NOTE 26: EXPERT, TELECOMMUNICATION, IT-SUPPORT FEES AND OTHER OPERATING EXPENSES

The Group classifies it's operation expenses according to the type of the cost incurred. Material items (like expert fees, telco fees and IT-support) are disclosed separately on the face of the Consolidated Statement of Comprehensive Income.

The other expenses are those operational items that do not fall into the previous categories. The breakdown of that line is the following:

	2017	2016
Other expenses		
Provisions for contract	786	0
Contracted services	263	339
Development costs	55	9
Taxes	466	213
Rental fees	106	126
Fees paid to authorities	87	91
Lawyer's fee	103	90
Fees paid for education	41	50
Material type expenses	43	49
Insurance fees	14	13
Marketing cost	9	1
Other	58	35
	2 031	1 016

KELER identified that a contract of the Group is onerous therefore a provision was recognized. When recognizing provisions for onerous contract, the Group only considered legal and constructive obligations existed at the end of the reporting period. The management makes best effort to avoid additional payment from this contract, however due to the fact that further negotiations are in progress, the Group does not wish to disclose any additional information regarding this provision.

The material increase in the taxation expense is due to the change of the basis of bank tax. The other changes are due to the change of the underlying operation.

The rental fees include buildings (office and server spaces) leases. These leases are operating leases. The lease commitment for the effective leases is the following:

	31.12.2017.
In 1 year	81
Over 1 year but no later than 5 years	351
Over 5 years	-
Total commitment	**432**

NOTE 27: OTHER INCOME AND EXPENSES, FINANCIAL INCOME AND EXPENSES

Certain sundry incomes and expenses that cannot be classified as operating activities or do not relate to the activity of the Group are presented as other incomes and expenses. These items include gains and losses on disposing property, plant and equipment.

Foreign exchange gains and losses are presented as financial income and expenses together with net interest income of those entities of the Group whose core activity does not include banking services.

NOTE 28: INCOME TAX EXPENSE

The Entity considers corporate income tax and for KELER only local tax and innovation contribution to be income tax for accounting purposes.
The corporate income tax rate is 9% (pervious year: 19% and 10% (up to HUF 500 million profit)) in Hungary. The local tax is 2%, and for the innovation contribution it is 0,3%. The tax base of latter two is derived from the gross profit (actual gross profit or in case of the depository activity the net interest).

A breakdown of the income tax expense is:

	2017	**2016**
Income Taxes		
Current corporate income tax	125	314
Deferred corporate income tax	(175)	(188)
Local tax	120	126
Innovation contribution	17	19
	86	271

The details about the deferred tax is in Note 17. The tax rate changed effective from 2017 in Hungary to 9% flat rate. The details of this change and the effect is detailed in Note 17.

NOTE 29: OTHER COMPREHENSIVE INCOME

The other comprehensive income includes two elements: the revaluation of the available for sale financial instruments and the retranslation of the foreign operation to the functional currency of the Parent Company.

Both balances to be reclassified to the profit or loss when the financial instruments are derecognised or the foreign operation is disposed.

	2017	2016
Other comprehensive income		
Remeasurement gain on AFS financial assets	86	368
Retranslation and disposal of foreign operation	-	-
	86	368

NOTE 30: SECURITIES SAFEGUARDED AND DEPOSITED; OFF BALANCE SHEET ITEMS

Foreign securities means amounts in security accounts of the counterparties.

	NOMINAL (PAR) VALUE	
	31.12.2017	**31.12.2016**
SECURITIES		
Physical securities		
Physical securities HUF	146 805	153 181
Physical securities CHF	1 467	1 600
Physical securities USD	-	9
	148 272	**154 790**
Dematerialized securities		
Dematerialized securities HUF	31 884 892	28 324 775
Dematerialized securities AUD	721	178
Dematerialized securities CAD	88	170
Dematerialized securities CHF	30 496	34 879
Dematerialized securities CNY	47	-
Dematerialized securities CZK	99 056	103 053
Dematerialized securities DKK	3	-
Dematerialized securities EUR	2 385 415	2 015 058
Dematerialized securities GBP	3 611	1 086
Dematerialized securities HKD	59	75
Dematerialized securities NOK	2	3
Dematerialized securities PLN	20 548	25 609
Dematerialized securities RON	224	223
Dematerialized securities RUB	98	-
Dematerialized securities SEK	11	48
Dematerialized securities SGD	-	22
Dematerialized securities TRY	85	103
Dematerialized securities USD	357 743	192 905
Dematerialized securities ZAR	-	1
	34 783 099	**30 698 188**
	34 931 371	**30 852 978**

NOTE 31: OFF BALANCE SHEET ITEMS

	31.12.2017	31.12.2016
Guarantees received		
Cash		
In HUF	18 320	18 052
In foreign currency	27 106	10 810
Security	29 199	25 568
Bank guarantee	3 542	2 833
	78 167	**57 263**

	31.12.2017	31.12.2016
Specific safeguards		
Cash		
In foreign currency	16 045	7 926
Bank guarantee	43	43
	16 088	**7 969**

Under specified circumstances these items maybe used by the Group. When certain market irregularity occurs (i.e. insolvency of a participants) the safeguards are used according to strictly regulated order to cover the losses.

NOTE 32: RELATED PARTY TRANSACTIONS

A number of transactions are entered into with related parties and owners of the Group in the normal course of business. These include deposit placed and services provided. These transactions were carried out on commercial terms and at market rates. The volumes of related party transactions, outstanding balances at the end of reporting period, and relating income and expense for the year are as follows.

CENTRAL BANK OF HUNGARY	**31.12.2017**	**31.12.2016**
Term deposit placements	10 959	17 350
	10 959	17 350

	2017	**2016**
Interest income	70	205
Other income	0	0
	70	205
Bank account costs	16	13
Other costs	0	0
	16	13

As stated before the parent of the Group is the Central Bank of Hungary (CBH). CBH is a government-related entity (as defined by IAS 24). This Group uses the exemption in IAS 24.25 and does not make disclosures regarding balances and transactions with other government related entities. These transactions with other government related entities are immaterial and if they exist they are at arm's length condition.
Members of the key managements are related parties.
Key management (during the period preparing the financial statements):

Board of Directors
- Dr. Selmeczi-Kovács Zsolt, chairman of BoD
- Mónus Attila, chief executive officer
- Szalai Sándor, director of operation
- Balogh Csaba Kornél, member of BoD
- Nagy Márton, member of BoD
- Végh Richárd, member of BoD

Supervisory Board
- Bartha Lajos, chairman of SB
- Kardos Miklós,
- Pintér Klára
- Varga Lóránt

	2017	**2016**
Board of Directors	145	121
Supervisory Board	25	20
	170	141

These are all short term employee benefits.
Remunerations above include all type of disbursement paid to members of Directory Board and Supervisory Board. Other than the above stated remuneration no transactions are made with the foresaid people.

NOTE 33: CLASSIFICATION AND FAIR VALUE OF FINANCIAL INSTRUMENTS

a) Classification of financial instruments

31 December 2017	Receivables	Available for sale assets	Other assets or liabilities at amortized cost	**Total carrying amount**	**Fair value**
Cash and cash equivalents	24 564			**24 564**	**24 564**
Placements with other banks	41 300			**41 300**	**41 300**
Available for sale financial assets		50 570		**50 570**	**50 570**
Receivables relating to clearing and depository activities	18 392			**18 392**	**18 392**
Deposits from customers			102 216	**102 216**	**102 216**
Accounts payable			4 330	**4 330**	**4 330**

31 December 2016	Receivables	Available for sale assets	Other assets or liabilities at amortized cost	**Total carrying amount**	**Fair value**
Cash and cash equivalents	31 901			**31 901**	**31 901**
Placements with other banks	21 232			**21 232**	**21 232**
Available for sale financial assets		53 119		**53 119**	**53 119**
Receivables relating to clearing and depository activities	11 918			**11 918**	**11 918**
Deposits from customers			86 080	**86 080**	**86 080**
Accounts payable			3 862	**3 862**	**3 862**

b) Assets and liabilities measured at fair value – Fair value hierarchy

31 December 2017	Fair value Level 1	Fair value Level 2	Fair value Level 3	Total
Financial assets available for sale		50 570		50 570

31 December 2016	Fair value Level 1	Fair value Level 2	Fair value Level 3	Total
Financial assets available for sale		53 119		53 119

c) Assets and liabilities measured at non-fair value – Fair value hierarchy

31 December 2017	Fair value Level 1	Fair value Level 2	Fair value Level 3	Total
Cash and cash equivalents	24 564			24 564
Placements with other banks			41 300	41 300
Receivables relating to clearing and depository activities			18 392	18 392
Deposits from customers			102 216	102 216
Accounts payable			4 330	4 330

31 December 2016	Fair value Level 1	Fair value Level 2	Fair value Level 3	Total
Cash and cash equivalents	31 901			31 901
Placements with other banks			21 232	21 232
Receivables relating to clearing and depository activities			11 918	11 918
Deposits from customers			86 080	86 080
Accounts payable			3 862	3 862

No items were classified as fair value through profit or loss, or held to maturity during the years presented.
Receivables or similar itmes including counter party risk where the risk factor is not readily determinable are classified under Level 3 measurement.

NOTE 34: SUBSEQUENT EVENTS

The management proposes a zero dividend.

There were no material subsequent event identified during the preparation of the financial statements for the year ending on 31st December 2017, that requires disclosure.

NOTE 35: CHANGES IN ACCOUNTING POLICIES, EXPECTED EFFECTS OF NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED, EARLY ADOPTIONS

The potential impact of revised IFRSs and IFRICs becoming effective after the reporting date on the Group's financial statements are described below in detail. The potential impact of ongoing amendments to IFRSs and IFRICs at the reporting date is not examined in detail as they do not have a significant impact on the financial statement and disregarding them will not affect the decisions of the users of the financial statements.

The following standards and interpretations (including amendments thereto) will become effective in FY 2018 or later.

Standards issued but not yet effective

IFRS 9 Financial Instruments

IFRS 9 Financial Instruments will replace the current IAS 39 standard. According to the 2014 amendments, the application of this standard is mandatory as of 1 January 2018. The Group has certain financial instruments (which are all debts instruments) that are valued at fair value since they are available for sale. That category will not exist in the upcoming standard.

The Group observed its investment policy and concluded that the following investments can be distinguished:

Certain instruments (Discount Treasury bills) are held to ensure the liquidity needs of the Group and also to yield profit by holding these instruments. Therefore the business model is both 1) to hold these assets for the purposes of collecting contractual cash flows or 2) realization profit on selling them. These instruments will be classified as debts instruments measured at fair value through other comprehensive income (FVTOCI) category. This means that these items will be remeasured at the end of every period with the gain or loss taken to OCI. This OCI will be reclassified to the profit or loss when the item will be derecognized.

Other instruments (Government bonds) are going to be held for purposes of collecting the contractual cash-flows, therefore concluded that this business model requires the amortized cost classification and measurement

Both above mentioned instrument meet the cash-flow characteristic test, since the contractual cash-flows consist of payments of interest and principal repayment (they are plain vanilla instruments).
Both of these classes of instruments were classified as available for sale previously. Therefore the Government bonds – on transition to IFRS 9 – will be stated as if amortized cost were always used, therefore their book value will be reduced on transition with the previously recorded revaluation reserve recorded in other comprehensive income. (The carrying amount without the fair value adjustment as amortized cost of the instruments will remain unchanged on transition).

The Group concluded that in case of the other financial instruments no significant change is expected to happen in terms of classification and measurement.

- Other debt instruments are going to be classified as financial instruments at amortized cost.
- The Group does not hold currently equity instruments

IFRS 9 also reconsidered the impairment of financial instruments, introducing the expected loss model. Instead of incurred (actual) losses, the basis of accounting will be the expected loss. The expected loss model requires for an earlier recognition of impairment losses. The approved model contains a simplified method allowing entities to use simplified rules instead of the complex ones for certain financial assets (e.g. trade receivables and similar instruments). This solution is expected to be very similar to the approach which is already adopted by the Entity in respect of such instruments. Since these items represent by far the largest share in the Entity's financial instruments, adoption is not likely to have any significant numeric impact, although the calculation of such an impact is still in progress.

All the treasury bills and government bonds are going to be considered to be stage 1 instruments, therefore a 12 months expected credit loss allowance will be established by debiting the retained earnings.

IFRS 9 also contains new regulations regarding hedge accounting which provide that a much wider range of relationships (economic events) will qualify for hedge accounting and the previously applicable compliance criteria (hedge effectiveness and evidence for the existence of effectiveness) will be less strict. The Group does not apply hedge accounting, which means that this change cannot have any impact on the financial statements.

IFRS 9 has been endorsed by the EU and the Group will not early apply IFRS 9.

See more information about expected future effect on transition to IFRS 9 in *Note 36*.

<u>IFRS 15 Revenue from Contracts with Customers</u>

This standard contains conceptual changes regarding the methodology for recognising revenue. The mandatory effective date of the standard is 1 January 2018. A range of standards and interpretations are no longer effective as a result of the amendment:

- IAS 18 Revenue
- IAS 11 Construction Contracts

- IFRIC 13 Customer Loyalty Programmes
- IFRIC 15 Agreements for the Construction of Real Estate
- IFRIC 18 Transfers of Assets from Customers
- SIC 31 Barter Transactions Involving Advertising Services

IFRS 15 provides a single model for revenues derived from contracts. The standard uses a single five-step model to determine the amount and timing of revenue recognition. This standard contains explicit requirements for situations where multiple items are transferred to a customer at once. IFRS 15 provides two methods for the timing of recognising revenue: recognition at a point in time or over time. IFRS 15 also introduces guidance on the treatment of costs associated with the acquisition of contracts and their provision (not elsewhere classified).

The Group performed calculations during the pervious year, and concluded that there will be no difference between the revenue recognized under the old standards and IFRS 15. The reason for this is that all the services rendered by the entity are finalized within a month and the pricing structure builds on a simple list price.

IFRS 15 is applied starting from 1st January 2018.

Since the Group preliminary concluded that there will be no difference between the methodology of revenue recognition under IFRS 15 the Group plans to apply IFRS 15 in accordance with the fully retrospective transitional approach without using the practical expedients for completed contracts in IFRS 15.C5(a), and (b), or for modified contracts in IFRS 15.C5(c) but using the expedient in IFRS 15.C5(d) allowing both non-disclosure of the amount of the transaction price allocated to the remaining performance obligations, and an explanation of when it expects to recognise that amount as revenue for all reporting periods presented before the date of initial application, i.e. 1 January 2017.

<u>IFRS 16 Leases</u>

This standard fundamentally changes the accounting treatment of leases: as a general rule, all leased items are recognised by the lessee as an asset in its statement of financial position, along with the related lease liability. Operating leases as a category will be effectively abolished. The accounting treatment on the lessor's side is not subject to change, but the classification of leases will be. In addition to the fundamental changes, the new standard also amends measurement rules and allows a wider range of variable items to be included in the calculation of lease fees. Furthermore, the definition of lease is also subject to change and certain capacity usage contracts will no longer qualify as leases. The application of the standard will be mandatory as from 2019.

The Group is currently examining the other potential changes in its financial statements that the standard may cause. This standard has been endorsed by the EU.

<u>Equity method in separate financial statements (amendments to IAS 27)</u>

IAS 27 has been amended already in 2016 in such a way that, in addition to fair value measurement and measurement at cost, amounts derived using the equity method will also be accepted as a basis for measurement subsequent to initial recognition.

The Group does not currently prepare separate financial statements under IFRS and, therefore, this amendment does not have any direct impact on these financial statements at the moment. Starting from 2018 the Group will be required to prepare separate financial statements. Based on current plans the entity will measure investments in other entities at cost, therefore no impact is expected from this amendment.

Contribution of assets between an investor and its associate or joint venture

IFRS 10, IFRS 12 and IAS 28 have been amended so as to clarify the treatment of such events.

Any gain or loss on assets sold to an associate must be recognised by the investor in profit or loss in proportion to the share that the remaining members of the associate possess in that associate (provided that the assets contributed do not constitute a business under IFRS 3).

If the assets do constitute a business, the investor should recognise the entire amount of profit or loss.

Similarly, if an entity contributes a former associate which does not qualify as a business to one of the entity's associates or joint ventures, the resulting gain or loss will be recognised in proportion to the share of the remaining members. The amendment is effective as from January 2016. This amendment is not expected to have any impact on the Group's financial statements.

IFRS 2 Share based payments

The standard clarified that if in case of certain equity settled share based payments even if the grantor is required to retain certain amount of the share based payment promised to the employees (similar) in cash in order to meet taxation requirement, will not change the classification of this of the share based payment.

The modification also addresses the fact that if the equity settled share based payment will be converted into cash settled, the liability shall be recognized, the so far fulfilled part of the payment will be recognized in equity, measuring it using the fair values applicable on the day of the change. All difference arising will be taken to the Consolidated Statement of Comprehensive Income. This amendment will not have any effect on the financial statements, since there are no share based payments currently outstanding.

Other standards and interpretations

IAS 28 was modified, that if an associate may be measured at fair value due its status (ie. investment of the mutual fund, venture capital etc.) the entity may make the decision on the measurement on case-by-case basis. This amendment is applicable starting from 1st January 2018, and was not yet approved by the EU. This modification is expected to have no effect on the Group financial statements.

IAS 40 was modified to clarify, that the reclassification from and to investment property category may only be done if the underlying building will start or stop to meet the definition. A simple management intention is not triggering reclassification. This is applicable starting from 1st January 2018. The Group does not have investment properties, therefore this change will have no effect on the financial statements.

IFRS 12 was modified to make clear that the requirements of the standard is applicable also for entities held for sale or classified as part of a disposal group.

IFRIC 22 is a new interpretation which is dealing with foreign currency transactions and advance consideration. A consensus was reached that the advances in foreign currency are not remeasured at the end of the period. When the advance is paid for a non-monetary item, this not-monetary item will be recognized at the rate of the advance and will not be remeasured when it is actually recognized. If there are more advances paid, each advances rate will be carried forward to the book value of the asset.

IFRIC 23 is a new interpretation that requires the entities to assess the effect of tax audits and uncertainties of tax positions. The interpretation requires the entity the make judgement about the expected outcomes and also prepare adequate disclosures. This standard is effective starting from 1st January 2019. The Group assesses the effect of this interpretation in 2018.

The effect of all other changes to IFRSs – here not mentioned – not yet adopted is not expected to be material (if any).

NOTE 36: TRANSITION TO IFRS 9

Since the financial instruments form a material part of the Group's asset the transition to IFRS 9 Financial Instruments (from the previous IAS 39 standard) will have material impact on both the Consolidated Statements of Financial Position and the Consolidated Statement of Comprehensive Income of the Group.

The Group only possesses instruments that qualify to be debt instrument (government bonds and bills), the Group is not allowed to hold equity instruments. Therefore, on the transition the correct classification and the measurement of these assets are the key accounting matters.

The Group started a project during the 2017 business year, to analyze whether the cash-flow characteristic test is met for the above stated financial instruments. The foresaid instruments are not complex in nature so the Group concluded that both the government bill and the government bond meets the cash flow characteristic test.

The project then analyzed the business model of the Group. This concluded that there are two subsets in the current portfolio:

- *Government bond:* this part of the portfolio is going to be classified in the amortized cost category (AC) since these instruments are going to be held until their maturity and the primary gain from these assets are the interest earned through them;

- *Discount Treasury bills:* these short term instruments are held with the purpose of resale (if needed) or they might be held to maturity depending on short term tendencies. Therefore these assets are classified in the fair value trough other comprehensive category (FVTOCI) with the cumulative gain reclassified to the net profit on disposal.

Under IAS 39 these assets are classified in the available for sale category (see Note 6 and Note 35). The transition rules require the Group to apply the measurement rules of these assets retroactively, i.e. the opening balances are recalculated as if the measurement rules were always applicable.

- The previous revaluation of the discount treasury bills are not eliminated, only the name of the reserve is changed to refer to the terminology of IFRS 9. This will not alter the book value of the asset.
- Government bonds: the previous revaluation of the government bonds are going to be eliminated against the carrying amount of the asset. (The previous revaluation were recognized in the AFS asset revaluation reserve in other comprehensive income).

IFRS 9 has exhaustive requirements on the recognition of credit losses. Both of the above stated instruments are going to require an allowance for their calculated ECL. At the date of transition to IFRS 9 (i.e. 1st January 2018.) the Group will determine which stage the assets do belong to. The assessment concluded that all financial instruments are in Stage 1 (on the date of the transition). Furthermore the ECL allowance of the assets are calculated and the effect is recognized as an adjustment of opening retained earnings.

	Government bond	**Discount Treasury bill**	**Total**
Carrying amount as per IAS 39	15 162	37 953	**53 115**
Elimination of previous revaluation (in retained earnings)	(1 006)	-	**(1 006)**
Elimination of previous revaluation (in AFS reserve)	(527)	-	**(527)**
Expected credit loss allowance	(2)	(5)	**(7)**
Opening book value per IFRS 9	**13 627**	**37 948**	**51 575**
Total difference in opening equity	*(1 535)*	*(5)*	*(1 540)*

All other financial instruments are going to be unaffected by IFRS 9 (there are no material differences identified).

The above stated numbers are current estimations. The IFRS 9 transition is still in progress. The management does not expect to have significant changes in the above disclosed figures.

NOTE 37: APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were authorized for issue by the Board of Directors on 11 May 2018.

Budapest, 27 April 2018

Attila Mónus
Chief Executive Officer