Česká spořitelna

Half-Year Report 2018

International Financial Reporting Standards,
Consolidated & Unaudited

ČESKÁ spořitelna

HOW SUCCESSFUL ČS WAS
IN THE FIRST HALF OF 2018

We help people fulfil their dreams about housing

26.9 BN CZK
VOLUME OF NEW MORTGAGES

AN EQUAL AMOUNT WAS INVESTED IN ADVERTISING IN CZECH REPUBLIC IN 2017

-15.2%

We help people fulfil their dreams and wishes

17.8 BN CZK
NEWLY GRANTED CASH LOANS

ROUGHLY THIS WAS THE APPROXIMATE AMOUNT OF PROCEEDS FROM AN AUCTION OF ART FROM THE US BILLIONAIRE DAVID ROCKEFELLER COLLECTION

+2.3%

We help companies in their development and innovations

278.9 BN CZK
LOANS TO COMPANIES AND CORPORATE CLIENTS

+22.8%

THE SAME AMOUNT WAS GRANTED BY ALL CZECH BANKS IN HOUSING LOANS FOR THE WHOLE 2017

We help our clients invest

132 BN CZK
MUTUAL FUNDS

+12.6%

THIS AMOUNT WOULD COVER THE EXPENDITURES OF THE CITY OF PRAGUE FOR FULL TWO YEARS

120 BN CZK
ASSET MANAGEMENT

-2.3%

THIS AMOUNT WOULD SUFFICE TO COVER ONE HALF OF THE COST OF ORGANISING A FOOTBALL WORLD CHAMPIONSHIP

80.7 BN CZK
PENSION FUNDS

THIS AMOUNT WOULD COVER TWO ANNUAL BUDGETS OF THE CZECH MINISTRY OF TRANSPORT

+9.3%

SOCIETY TRUSTS US

81.1 BN CZK
PUBLIC SECTOR DEPOSITS

THIS IS NEARLY THE SAME AMOUNT THAT THE GOVERNMENT COLLECTED IN TAXES IN 2016

650.4 BN CZK
DEPOSITS FROM HOUSEHOLDS

188.3 BN CZK
CORPORATE DEPOSITS

10,086
HEADCOUNT

4.6 MN
CLIENTS

1.7 MN
FOLLOWERS IN MASS MARKET

NPS 10

FINANCIAL RESULTS
YEAR-ON-YEAR COMPARISON

Net fee and commission income -4.2%

Net interest income +6.5%

Operating expenses +1.5%

Net profit +2.6%

7.9 BN CZK

Operating profit +0.9%

9.5 BN CZK

Growth since the beginning of the year

Gross loans to clients +15%

Total deposits from clients +4.1%

Total assets +7.8%

ČESKÁ spořitelna

Content

Macroeconomic Development of the Czech Republic

For the First Half of 2018

In the first half of 2018, the favorable development of the Czech economy continued. Its growth was driven by both the continued recovery in the Euro Area and strong domestic demand. The labor market strengthened further in the first half of 2018, as the unemployment rate fell and wage growth accelerated. Inflation was close to the inflation target, controlled by the gradual increase of interest rates by the Czech National Bank (hereinafter ČNB) and the appreciation of the CZK. Economic risks remained very low during the first half of 2018.

In the first and second quarter of this year, the y/y growth of gross domestic product (hereinafter GDP) of the Czech economy reached 4.1%[1] and 2.4%[2] respectively, from the 4.5%[3] reached last year (average). GDP growth therefore slowed down towards values that are sustainable in a longer term. The growth was driven mainly by strong domestic demand. Household consumption was propelled by the tight labor market and associated strong wage growth. The upswing in investment activity was stimulated by the recovery in the Eurozone as well as an escalating shortage in the labor force (which forces companies to invest more in robotics and automation). The GDP growth slowdown compared to last year was mainly due to tighter monetary conditions (higher rates and a stronger koruna exchange rate). Still, the growth remains high and the Czech economy continues in its convergence towards the developed countries of Western Europe.

During the first half of this year, inflation was close to the 2% inflation target of the ČNB[4]. At the beginning of 2018, the price increase slowed down, as annual inflation surprisingly declined slightly below 2%[5]. However, this development was only temporary and inflation increased slightly above the target over the second quarter as it arrived at 2.6%[6]. The main pro-inflationary pressures are strong domestic demand, growth in firms' wage costs and oil and food prices. The main anti-inflationary factors are the current high investment of companies in robotics and automation (with an increase in productivity and hence positive supply shock), rising interest rates and, in the medium term, the appreciating CZK. In the second quarter, however, the CZK weakened, mainly due to the increase in global risks, and its effects were thus pro-inflationary.

After the strong performance in 2017, in the first half of this year, the labor market continued with further tightening. The economic recovery has translated into high demand for employees, and thanks to this strong demand, the unemployment rate fell to 2.4%[7] in June (the lowest in the EU[8]). Given the aforementioned very tight labor market conditions, wage growth accelerated significantly; in 1Q18, real wage growth arrived at 6.6%[9].

During the first half of 2018, the ČNB raised interest rates twice; the main two-week repo rate was set at 1.0%[10] at the end of June, which helped to tighten monetary conditions and thereby reduce the pro-inflationary impact of a growing economy and the tight labor market. Although the CZK should continue in its appreciation in the medium term, given the positive development of the Czech economy, during the first half of the year, this appreciation stopped and the koruna even weakened to close to CZK 26 per euro[11]. This depreciation was mainly due to external influences, including the faster than expected interest rate growth in the US, the risk of trade wars and the possibility of a deterioration of the economic development in Italy. Facing weak CZK, the ČNB increased interest rates again in June.

Yields of CZ government bonds increased during the first half of the year. This increase was supported by higher inflation in the Czech economy and the Euro Area and the increase in the ČNB's rates.

1 Source: Source: Czech Statistical Office, 18.9.2018. https://www.czso.cz/csu/czso/cri/tvorba-a-uziti-hdp-2-ctvrtleti-2018
2 Source: Czech Statistical Office, 18.9.2018. https://www.czso.cz/csu/czso/cri/tvorba-a-uziti-hdp-2-ctvrtleti-2018
3 Source: Czech Statistical Office, 3.4.2018. https://www.czso.cz/csu/czso/ari/quarterly-sector-accounts-4-quarter-of-2017
4 Source: Czech National Bank, 18.7.2018. https://www.cnb.cz/en/monetary_policy/inflation_targeting.html
5 Source: Czech Statistical Office, 9.3.2018. https://www.czso.cz/csu/czso/ari/consumer-price-indices-inflation-february-2018
6 Source: Czech Statistical Office, 9.3.2018. https://www.czso.cz/csu/czso/ari/consumer-price-indices-inflation-june-2018
7 Source: Czech Statistical Office, 20.8.2018. https://www.czso.cz/csu/czso/engaktualniinformace
8 Source: Eurostat, 20.8.2018. http://ec.europa.eu/eurostat/statistics-explained/index.php/Unemployment_statistics
9 Source: Czech Statistical Office, 18.7.2018. https://www.czso.cz/csu/czso/ari/average-wages-1-quarter-of-2018
10 Source: Czech National Bank, 18.7.2018. https://www.cnb.cz/en/monetary_policy/instruments/tabulka2018.html
11 Source: Czech National Bank, 18.7.2018. https://www.cnb.cz/miranda2/m2/cs/financni_trhy/devizovy_trh/kurzy_devizoveho_trhu/vybrane.html?mena=EUR&od=01.01.2018&do=31.12.2018

Consolidated Financial Results of Česká spořitelna

For the First Half of 2018

INCOME STATEMENT

Česká spořitelna reported an unaudited consolidated net profit (net result attributable to owners of the parent) **of CZK 7.9 bn in the first half of 2018**, according to International Financial Reporting Standards (IFRS). **This means an increase by 2.6%** compared to the same period of the previous year. The half-year net profit **was positively influenced by growing lending**, gradually rising net interest income and by release of credit risk provisions due to the high quality of the loan portfolio.

The Czech economy is experiencing a sustained period of favourable economic development and macroeconomic data are indicating that this positive development should last through the rest of the year. Economic recovery in the Eurozone **and growing disposable income of Czech households**, backed by an all-time low unemployment rate, **are supporting the aggregate demand** for goods and services, and consequently for loans.

Return on equity (ROE) increased to 12.9% from 12.5% in the first half of 2017 due to the increase of net profit. The increase of average volume of total assets contributed to the **slight decline of the return on assets (ROA) to 1.1%** from 1.2%.

Net profit was mainly influenced by the improved operating result. **Compared to the first half of the previous year, the operating result**, calculated as the difference between operating income and operating expenses, **went up by 0.9% to CZK 9.5 bn**. Major contributors to the growth of operating result were net interest income and stable other administrative expenses. **Cost/Income ratio is stabilized at 49.2%**, in the first half of 2017 it stood at 49.0%.

An increase in net interest income, representing more than 70% of total operating income, was supported by strong loan growth and four recent ČNB interest rate hikes. **Net interest income amounted to CZK 13.1 bn, which is 6.5% more than in the first half of 2017.** Despite growing net interest income, a **high volume of low-yielding repo operations with ČNB continue in decreasing the net interest margin related to interest earning assets**, from 2.73% to 2.15%. Excluding the exceptional growth of the average of these assets, the net interest margin reached 2.69%.

Net fee and commission income decreased by 4.2% to CZK 4.3 bn year-on-year, driven by shrinking income from payment services. By contrast, ČS acquired higher income from securities transactions, mainly mutual funds and asset management. **Česká spořitelna is the market leader in mutual funds and is further strengthening its market position.** Also income from the sale of insurance products increased.

Net trading result decreased by 26.7% to CZK 1.0 bn year-on-year, being negatively affected by lower income from FX transactions, securities business and by extraordinary demand for hedging activity in Q1 2017 in connection with the expected termination of the ČNB's currency interventions.

Total operating expenses increased by 1.5% to CZK 9.2 bn, which is well below the inflation rate. Personnel expenses, representing more than half of total operating expenses, increased by 3.9% to CZK 4.7 bn, influenced above all by growth in wages.

Other administrative expenses were slightly reduced, by 0.5% to CZK 3.5 bn year-on-year, despite a higher contribution to the Deposit Insurance Fund (+13.0%) in connection with a growing volume of insured deposits. Expenses on consultancy and office space declined, reflecting irregular payments. Depreciation of tangible and intangible assets also reported a decrease by 2.2% to CZK 1.0 bn.

Net gain from derecognition of financial instruments not measured at fair value through profit and loss recorded a significant drop, as Česká spořitelna realised profit from a one-off sale of selected securities in the first half of 2017.

Impairment result from financial instruments (i.e., creation of risk provisions for loans and advances, guarantees and unused limits) **reached a positive CZK 0.9 bn**, which means that Česká spořitelna experienced another net release of credit risk provisions. **Further improvement of the loan portfolio arrived** on the back of recovery of several large corporate clients and quality improvements in retail segments.

Other operating result of CZK -0.6 bn was affected mainly by mandatory contribution to the Resolution fund (CZK 488 m), other income and expenses not directly attributable to the Group´s ordinary activities, creation of reserves and results of the sale of tangible and intangible assets. **Total costs for contribution to the Guarantee System for the Financial Market** (Deposit insurance fund and Resolution fund) **amounted to CZK 734 m**.

Statement of Financial Position

(data for the comparable period are as of 1 January 2018, i.e. they reflect impact of methodology change concerning transition from IAS39 to IFRS9)

As at 30 June 2018, total consolidated assets again reached a record volume, amounting to CZK 1,431.8 bn which means an increase by 7.8% since 1 January 2018. There was a change in the structure of assets, with the volume of loans and advances to banks and customers being up, including reverse repo operations with the ČNB. By contrast, deposits placed in the Czech National Bank dropped sharply. On the liability side of the balance sheet, deposits from banks, including repo operations, went up and customer deposits also rose.

The expanding economy and active approach of Česká spořitelna contributed to a strong 10.0% growth of the total customer loan portfolio at amortised costs to CZK 696.1 bn (net volume). This means CZK 63.5 bn in absolute value. Excluding reverse repo operations which the Bank does not consider as a main business activity, **net customer loans increased by 6.2%. The gross volume of customer loans adjusted for reverse repo operations increased by 5.6% since the beginning of the year to CZK 683.7 bn.** All customer segments contributed to the loan growth, from households and small and medium-sized enterprises (SME) through to large corporate customers.

The greatest merit for the growth of retail loans has mortgages and consumer loans. **The growth of the gross volume of private mortgages since the beginning of the year reached 5.3%.** In absolute terms this represents CZK 12.4 bn. **The total volume of private mortgages thus amounted to CZK 245.8 bn** as of 30 June 2018. The growth reflects the attractive offer of Česká spořitelna, particularly in terms of long fixations. **The important ratio of average loan values to the value of real estate (loan to value ratio) is at a comfortable level of 58.8% for the whole portfolio** and 68.6% for new loans.

Client interest in property renovations and refurbishment was also reflected in the rise of **building loans of Stavební spořitelna ČS** (building society). The gross loan portfolio of SSČS **reached the level of CZK 39.5 bn**, which represents 5.1% growth within six months. Further growth was also recorded by **consumer loans**, which **added 3.9% since the beginning of the year to CZK 68.9 bn**, reflecting an increase in household consumption.

The gross volume of loans to corporate customers and to the Group Markets segment (wholesale loans), excluding reverse repo operations, increased by 6.0% to CZK 250.8 bn, due to strong growth in loans to large corporate customers (up by 8.4% since the beginning of the year) and to SMEs (up by 5.8%). The reported figure increased by 16.1% to CZK 278.9 bn. This result was significantly affected by volatile reverse repo operations with clients.

The good quality of Česká spořitelna´s loan portfolio is evidenced by the share of non-performing loans relative to the overall volume of client loans. This indicator has been stable **at the excellent level of 2.1%** since the beginning of the year.

Significant growth of reverse repo operations with the ČNB led to a doubling of loans to banks to the amount of CZK 320.7 bn. Thereof ČNB repo loans represent CZK 290.4 bn, whereas at the beginning of the year 2018 they amounted to CZK 135.5 bn.

Volume of debt securities in the portfolio of financial assets at amortised costs rose by 11.2% compared to the beginning of the year to CZK 186.0 bn. There are mostly debt securities issued by the Ministry of Finance of the Czech Republic (CZK 158.1 bn).

The item Cash and cash balances with central bank reflect a shift of deposits in the ČNB to higher yielding reverse repo operations booked in loans to banks. Deposits with the ČNB dropped by 55.5% to CZK 112.5 bn in the first half of 2018.

The value of tangible and intangible fixed assets decreased by 3.9% to CZK 14.2 billion, mostly tangible assets dropped. The volume of tangible assets represents CZK 9.3 billion, of which land and buildings account for 83%. Intangible assets amounted to CZK 4.9 bn.

Group deposits from customers, including FV deposits, increased by 4.1% compared to the beginning of the year and reached CZK 919.7 bn, excluding the impact of repo operations they grew by 4.5%. **Household deposits went up by 5.8%** to CZK 650.4 bn **within the six months of this year**, mainly deposits in personal accounts and savings products. Group corporate deposits net of repo operations declined by 9.8%, to CZK 163.4 bn in 2018. The reported volume (including repo operations) dropped by 9.4%, to CZK 188.3 bn. Public sector deposits increased by strong 33.9% to CZK 81.1 bn, mainly on current accounts.

Deposits from banks went up by 24.6% since the beginning of the year to CZK 367.8 bn. The major contributor was higher loans received within repo operations.

Equity attributable to owners of the parent reached CZK 114.4 bn which means a decline by 4.3% as a result of dividend payment in June 2018. **The total capital ratio** (Tier I and II) for the regulatory consolidated Česká spořitelna Group (CRR) as at 30 June 2018 **reached 17.3% and is on a high level**. As of 31 December 2017 the total capital ratio stood at 18.7%.

Significant Events and Business Operations

in the First Half of 2018

Retail banking

A milestone in the digital history of Česká spořitelna. This is how Česká spořitelna could describe the first half of the year 2018 because of the numerous innovations and digitization of product offer and services.

George

In mid-May and after a successful testing phase, Česká spořitelna introduced George – a state-of-the-art personalised Internet banking system enabling comprehensive management of family finances in real time.

George, which was created by an international team of developers within the Erste Group Bank, has been inspired by the intuitive design and control typical of social networks and mobile applications. It is built on an open banking platform and allows third-party applications and new functionalities to be added. Opening George to all Spořitelna clients puts an end to the twelve-month testing period in which George was trialled by more than half a million clients. By the start of 2019, George should have around 1.5 million users.

George is the first banking application on the market which can automatically analyse the financial behaviour of its users in real time and offer them personalised recommendations via SMS or a notification in the application to help them manage their financial affairs. George can issue roughly forty suggestions and recommendations in real time, which are personalised to reflect the financial behaviour of a specific client. The number of suggestions and recommendations will multiply over time.

Through the George Store, clients can use the application to top up their mobile phones, personalise George's appearance, access Click For Your Money, or get Online Mortgage or Overdraft loan products, all online. George also brings new ways of securing payment transactions. As early as autumn 2018, Česká spořitelna clients with the George mobile application will be able to pay at sales outlets directly by mobile phone instead of using a card and connect their accounts to eight other banks. George will also offer clients a new two-factor method of securing payment transactions through the George key application. This will become a new security feature and identify the client through an authentication PIN or biometric each time they access George.

My Healthy Finances

The My Healthy Finances strategic service (MZF) is used by almost a million Česká spořitelna clients and thanks to the service, the number of Spořitelna clients continues to rise, and the number of primary and digital clients is increasing. The service is based on advisory services and encourages clients to save and manage their family budgets more efficiently. In April, ČS began to encourage responsible financial behaviour by MZF service users. Clients who use at least four additional products in compliance with MZF rules will be rewarded with an annual bonus of up to CZK 600.

API

Česká spořitelna is the first bank on the Czech market to open the so-called sandbox for testing ČS API (Application Programming Interface) on the Erste Developer Portal to third parties. Eight types of Open API, including PSD2 API, are currently available on the portal. Selected clients can also access the Business 360 testing platform, which can connect to accounts in other banks in addition to ČS accounts.

Digitalised branches

Digital service is already a matter of course at all Česká spořitelna branches, and since the beginning of the year, they have been equipped with tablets. Advisors use them to teach clients how to use George and how to understand their overall financial situation. At selected branches, clients can already sign basic documents using tablets.

Česká spořitelna is continuing to develop its service model, which reinforces the role of the advisory services provided at its branches. Its third flagship branch was opened in Olomouc in the first quarter of 2018. It is one of fifty branches following the new design opened by the Bank in the year 2017. In the year 2018, Spořitelna plans to open 40 branches using the new concept.

Mortgages

In the first two quarters of the year 2018, Česká spořitelna led the domestic mortgage market with a 27% share. The free offer for property valuation helped sell new mortgages.

Česká spořitelna tested the possibility of monitoring mortgages online at two mortgage centres in Prague. Thanks to the new "Mortgage Monitoring" service, the client receives an overview of his mortgage from the moment it is first assessed to the signing of the contract.

Insurance

As part of its MZF services, Česká spořitelna also started offering non-life insurance products. It is offering real estate, home and car insurance. The Bank is concluding more than 10,000 non-life supplementary insurance contracts each month through its external call centre. Clients most often request insurance for their personal items and cards, legal expenses or travel insurance.

Česká spořitelna – Corporate Banking

Česká spořitelna managed to exploit the healthy domestic economy and transform a number of opportunities into successful deals. The volume of loans provided by the corporate banking division (including subsidiaries) reached CZK 278.9 bn as at 30 June 2018, representing a year-on-year increase of 22.8%.

Customer experience plays a key role in every activity. After 2017 unique activity – the rotation of bankers in corporate client operations – the Bank engaged in a major expansion in 2018. This activity should soon become known to the business community and make a positive impact on the perception of the Česká spořitelna – Corporate Banking brand.

In February, all 14 regional corporate centres began to use the second generation of digital credit applications and what is referred to as the Standard Loan Process. This, for example, further facilitates work for traders by automatically spreading the finance conditions when producing a loan proposal.

In cooperation with EDITEL, the top international provider of electronic document exchange services, Česká spořitelna launched its new service, ediFACTORING. The Bank is the first in the Czech Republic to use it to automate the market for short-term corporate receivables, which is worth about CZK 130 billion each year. The new service is primarily intended for companies which are part of larger supplier-customer supply chains. It speeds up and simplifies work with documents, which will result in faster funds transfers for clients as well as less manual work for people and errors on both sides. When launching the ediFACTORING service, Česká spořitelna also implemented a new product – reverse factoring (confirming). This allows up to 100% non-regression financing of invoices with a maturity of up to 240 days.

Česká spořitelna still maintains its dominant position in the public sector. It has further reinforced it through a memorandum of cooperation on the concept of smart cities and regions, which it concluded in April with Gordic. Thanks to this cooperation, over half of Czech towns and municipalities can let their citizens pay fees for municipal waste, parking, etc. via e-invoices, which is enabled by connecting their Internet banking to the GINIS system supplied by Gordic.

Social Banking

Česká spořitelna was the first bank in the Czech Republic to make EU money available to social enterprises in the Czech Republic. Spořitelna has signed an agreement with the European Investment Fund, providing the EIF with a guarantee of EUR 12 million in financing. Over the next five years it will be able to use these funds for social enterprises. By signing the agreement with the EIF, ČS has confirmed its leading position in financing social enterprises.

ČS will primarily provide social enterprises with operating and investment loans. In addition to financing, it will also offer strategic counselling and mentoring. Through its social banking, Česká spořitelna is successfully expanding its support for organisations with a social focus. The funding provided through social banking from its launch in 2015 is close to a billion crowns. The Bank has supported 350 projects.

Mutual funds

In the first half of the year, the Bank managed to increase its lead to first position in mutual funds brokerage (ČS is leading second-placed ČSOB by CZK 21.8 billion) with a volume of managed assets amounting to CZK 132.0 billion and a market share of 27.1% (according to AKAT data as of 30 June 2018).

Stock Small Caps is becoming increasingly popular with clients. In its first year, more than CZK 3.3 bn was invested and it has very quickly become the third largest mutual funds in the Czech Republic with the value of its share certificate increasing by 27.21% (data as of 29 June 2018).

REICO Investment Company

The ČS Real Estate Fund, which is managed by Česká spořitelna's REICO investment company, continued to optimise its portfolio. At the beginning of the year it sold its administrative building at Táborská 31 in Prague, one of the longest-held properties in its portfolio. In the spring it purchased two new premium properties – an industrial park near the town of Dubnica nad Váhom in Slovakia and the Metronom Business Centre in Prague. The fund owns 14 properties in the Czech Republic, Slovakia and Poland, with a total value of almost CZK 23 billion.

The acquisition of the logistics park in Dubnica nad Váhom for CZK 990 million was one of the largest acquisitions in the industrial property sector in Slovakia and the Czech Republic, in the past 12 months. It has enabled the ČS Real Estate Fund to significantly expand the overall sectoral and regional diversification of its portfolio.

The purchase of the Metronom Business Centre office complex for CZK 2.3 billion has been the largest office transaction in 2018 in the Czech Republic. After the purchase of the Metronom Business Centre, approximately 53% of the fund's real estate assets are in the Czech Republic, which is in line with its long-term investment strategy.

General Meeting

At the General Meeting held on 30 April, Česká spořitelna shareholders approved the distribution of profits for 2017 and the payment of a gross dividend of CZK 77 per share. A total of CZK 11.7 billion was paid out in dividends. Česká spořitelna reported a net profit after tax of CZK 15.0 billion in 2017. The remainder of the profit not paid out in dividends was used by the Bank to create a capital fund to pay the proceeds of its hybrid capital tier 1 (CZK 604.4 million) and to increase its registered capital (in the form of retained earnings).

Awards received

Česká spořitelna celebrated its seven successes in the Zlatá koruna competition, which evaluates the financial products available on the Czech market. The Bank received its fourth consecutive award for social responsibility, in 2018 for its financial literacy programme, which was dominated by the Money Alphabet project. It also won gold in the mortgage loans and cards categories – for its prestigious debit card VISA INFINITE for Premier accounts –while Česká spořitelna's business loan, Startup ČS New Blood, took silver. Česká spořitelna's sister companies and subsidiaries also celebrated in the Zlatá koruna competition. The open mutual fund, Top Stocks, from Erste Asset Management, won first prize in the mutual fund category. Stavební spořitelna České spořitelny won the gold medal for Online building savings and the bronze crown for its Úvěr od Buřinky loan, intended for reconstruction.

The Erste Private Banking service was again designated the best private banking service in the Czech Republic in year 2018 by the prestigious magazine World Finance.

Česká spořitelna won the Consensus Economics 2017 Forecast Accuracy Award for the best forecasts on the Czech economy. Consensus Economics, which grants this award, follows the forecasts of more than twenty domestic and foreign institutions attempting to anticipate developments in the Czech economy. The accuracy of annual forecasts is assessed, showing the analytical team's ability to estimate the medium-term development of the economy.

We believe in good things

The Česká spořitelna foundation is the largest banking foundation in this country and emphasises systemic changes in education and social entrepreneurship, investing around CZK 60 million each year in the development of our civil society. Since January 2018, it has operated under a single brand (previously as Nadace České spořitelny and Nadace Depositum Bonum). In January 2018, two spin-off programmes were generated by the foundation – Učitel naživo, z. ú., and Elixír do škol, z. ú. In January 2018, the foundation also announced the prize winners for the fourth annual Floccus Prize, which is awarded to individuals and organisations in the non-profit sector.

Česká spořitelna realises the importance of people understanding the financial world from a very early age and has therefore focused on improving financial literacy, starting with young children. Thanks to the Money Alphabet project, primary school pupils across the country have learned about the world of business and how finance works. Several weeks of activities in which pupils work with Bank employees culminates in fairs selling goods at ČS branches. In the first half of 2018, eighty-nine fairs were organised, earning CZK 1,178,830. The financial literacy programme won accreditation from the Ministry of Education, Youth and Sports of the Czech Republic in January 2018, and in May 2018, it was awarded the Zlatá koruna award for social responsibility. The programme guarantor was the well-known youtuber Kovy (Karel Kovář), and the first project in which he actively participated was an exhibition called "Jak se točí peníze" ("The Money Cycle"), which attracted more than twelve thousand visitors to the Plzeň venue DEPO2015 from October 2017 to April 2018.

At the beginning of 2018, the Bank increased its partner universities by adding VŠ Škoda Auto. This is the eighth university it supports. It attempts to give students practical training, and its employees gave more than 50 lectures and workshops on various themes and disciplines in the first half of the year. Students also worked on semester projects for the Bank. Students from ČZU produced the most voluminous piece of work, mapping the CSR for Spořitelna, comparing it with the competition and subsequently proposing a CSR strategy for universities.

Expected Development at Česká spořitelna

in the Second Half of 2018

In the second half of 2018, Česká spořitelna aims to continue fulfilling its long-term mission, which is to lead its clients into prosperity. By achieving this goal, ČS will contribute to the development of Czech society as a whole. The cornerstone of Česká spořitelna's efforts to achieve this strategic goal is to continue developing and offering its advisory service, My Healthy Finances (MZF), which gives an access to a wide range of clients to advisory services as well as improved and simpler overviews of their expenditure and potential optimisation. In the second half of 2018, ČS expects the number of clients using the MZF service to exceed one million, with MZF now being available to clients at our branches and on tablets.

In addition to the MZF service, Česká spořitelna adds the banking of future 'George' with its mobile version. ČS is also aiming for a million users and wants to achieve this figure in the second half of the year while handling a major part of the logistically complex process of migrating clients from their existing popular, but hard to adapt, Servis 24.

Thanks to future positive macroeconomic developments expected in the Czech Republic, Česká spořitelna anticipates stable development of Bank's business and financial results, which will be supported to the same extent by the Bank's growing customer base.

As part of the balance of assets and liability in the second half of this year, the Bank expects a gradual increase in the volume of loans to clients. In connection with the effects of the ČNB's restrictions on mortgage lending, ČS cannot rule out the possibility of a certain slowdown in the growth rate of mortgage volumes compared to previous periods. The growth in primary deposits will also continue. Based on these assumptions, the Bank only expects slight variations in the current ratio between loans and deposits.

The profit and loss statement in the second half of the year is expected to be substantially similar to the first half. The volume of net interest income will be affected by an expected increase in interest rates and changes in the structure of assets and liabilities. Increased client activity in the area of investment in mutual funds and securities will make a positive contribution to net income from fees and commissions, while at the same time the continuing pressure of competition from new banks on the Czech market will have a negative impact. Developments in credit risk provisions will promote the achievement of planned profits. The benefits of implementing selected group and local projects and efforts to improve operational efficiency will also play an important role.

Selected Financial Indicators

Key Ratios

In CZK million	30 June 2018	30 June 2017
Return on equity (ROE)	12.9%	12.5%
Return on assets (ROA)	1.1%	1.2%
Cost / Income	49.2%	49.0%
Net interest margin in relation to interest-earning assets	2.15%	2.73%
Non-interest income / operating income	29.5%	32.7%
Loans and advances to customers / amounts owed to customers	75.9%	72.5%
Consolidated capital adequacy (BASEL III, Tier I and II)	17.3%	19.2%

Selected Operating Figures

In CZK million	30 June 2018	30 June 2017
Average headcount of Česká spořitelna Financial Group	10,086	10,197
Total number of clients	4,644,939	4,684,033
Number of SERVIS 24 and BUSINESS 24 direct banking active clients	1,880,945	1,789,254
Number of cards	2,838,650	2,915,106
of which: credit cards	181,193	194,696
Number of ATMs and payment machines	1,709	1,652
Number of Česká spořitelna branches	504	532

Net Profit of Selected Subsidiaries of Česká spořitelna
under International Financial Reporting Standards

in CZK million	H1 2018	H1 2017
Česká spořitelna – penzijní společnost, a. s.	114	104
Erste Leasing, a. s.	30	34
Factoring České spořitelny, a. s.	34	36
REICO investiční společnost České spořitelny, a. s.	41	39
S Autoleasing, a. s.	53	54
Stavební spořitelna České spořitelny, a. s.	420	384

Affidavit

The signatories of this document represent that according to their best knowledge the consolidated interim report provides a true and fair view of the financial position, business operations and financial results of Česká spořitelna and its consolidated group for the six months just ended and on the future prospects of its financial position, business operations and financial results.

Tomáš Salomon
Chairman of the Board of Directors

Wolfgang Schopf
Vice-chairman of the Board of Directors

Financial Statements

Interim Consolidated Financial Statements

for the Period Ended 30 June 2018

Prepared in Accordance with International Accounting Standard IAS 34: Interim Financial Reporting (Unaudited)

I. Consolidated Condensed Statement of Comprehensive Income

Income statement

in CZK million	Notes	1–6 2018	1–6 2017
Net interest income	1	13,144	12,345
Interest income		14,319	12,837
Other similar income		1,832	894
Interest expenses		(1,502)	(870)
Other similar expenses		(1,505)	(516)
Net fee and commission income	2	4,287	4,473
Fee and commission income		5,923	5,931
Fee and commission expense		(1,636)	(1,458)
Dividend income	3	50	46
Net trading result	4	1,041	1,420
Gains/losses from financial instruments measured at fair value through profit or loss	5	–	(18)
Net result from equity method investments		2	(12)
Rental income from investment properties & other operating leases	6	111	159
Personnel expenses	7	(4,694)	(4,517)
Other administrative expenses	7	(3,457)	(3,473)
Depreciation and amortisation	7	(1,009)	(1,031)
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	8	–	269
Gains/losses from derecognition of financial assets measured at amortised cost	9	6	–
Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss	10	24	–
Net impairment loss on financial assets	11	–	265
Impairment result from financial instruments	12	903	–
Other operating result	13	(559)	(368)
Pre-tax result from continuing operations		**9,849**	**9,558**
Taxes on income	14	(1,992)	(1,891)
Post-tax result from continuing operations		7,857	7,667
Net result for the period		**7,857**	**7,667**
Net result attributable to non-controlling interests		(13)	(6)
Net result attributable to owners of the parent		**7,870**	**7,673**

Statement of Comprehensive Income

in CZK million	Notes	1–6 2018	1–6 2017
Net result for the period		**7,857**	**7,667**
Other comprehensive income			
Items that may not be reclassified to profit or loss		**190**	**–**
Fair value changes of equity instruments at fair value through other comprehensive income		237	–
Fair value changes of financial liabilities at fair value through profit or loss attributable to changes in own credit risk		2	–
Deferred taxes relating to items that may not be reclassified		(49)	–
Items that may be reclassified to profit or loss		**(1,237)**	**(1,528)**
Available for sale reserve		–	(1,176)
Gain/(loss) during the period		–	(1,176)
Debt instruments at fair value through other comprehensive income		(654)	–
Gain/(loss) during the period		(562)	–
Reclassification adjustments		(24)	–
Credit loss allowances		(68)	–
Cash flow hedge reserve		(893)	(690)
Gain/(loss) during the period		(893)	(690)
Currency translation		12	(16)
Gain/(loss) during the period		12	(16)
Deferred taxes relating to items that may be reclassified		298	354
Gain/(loss) during the period		293	354
Reclassification adjustments		5	–
Total other comprehensive income		**(1,047)**	**(1,528)**
Total comprehensive income		**6,810**	**6,139**
Total comprehensive income attributable to non-controlling interests		(13)	(6)
Total comprehensive income attributable to owners of the parent		**6,823**	**6,145**

II. Consolidated Condensed Statement of Financial Position

in CZK million	Notes	Jun 2018	Dec 2017
Assets			
Cash and cash balances	15	139,810	280,221
Financial assets – held for trading	16	11,943	11,433
Derivatives		11,438	11,301
Other financial assets held for trading	17	505	132
Thereof pledged as collateral		139	1
Financial assets at fair value through profit or loss	18	–	407
Non-trading financial assets at fair value through profit or loss	19	1,135	–
Equity instruments		380	–
Debt securities		688	–
Loans and advances to banks		–	–
Loans and advances to customers		67	–
Financial assets – available for sale	20	–	55,283
Thereof pledged as collateral		–	2,781
Financial assets at fair value through other comprehensive income	21	52,409	–
Equity instruments		1,266	
Debt securities		51,143	
Financial assets – held to maturity	22	–	163,679
Thereof pledged as collateral		–	76,334
Loans and receivables to credit institutions	23	–	157,525
Loans and receivables to customers	24	–	638,694
Financial assets at amortised cost	25	1,202,797	–
Thereof pledged as collateral		61,235	–
Debt securities		186,045	–
Loans and advances to banks		320,701	–
Loans and advances to customers		696,051	–
Finance lease receivables	26	2,066	–
Hedge accounting derivatives	27	184	613
Property and equipment		9,302	9,913
Investment properties		2,372	2,372
Intangible assets		4,885	4,854
Investments in associates		765	762
Current tax assets		344	341
Deferred tax assets		1,483	1,000
Assets held for sale		280	19
Trade and other receivables	28	128	–
Other assets	29	1,907	2,107
Total assets		**1,431,810**	**1,329,223**

in CZK million	Notes	Jun 2018	Dec 2017
Liabilities and equity			
Financial liabilities – held for trading		11,772	11,414
Derivatives	16	11,772	11,414
Financial liabilities at fair value through profit or loss		1,452	1,240
Deposits from customers	30	1,452	1,240
Financial liabilities at amortised cost		1,288,615	1,179,929
Deposits from banks	31	367,762	295,232
Deposits from customers	31	918,266	881,997
Debt securities issued	31	935	1,805
Other financial liabilities		1,652	895
Hedge accounting derivatives	27	2,731	1,813
Provisions	32	2,903	2,778
Current tax liabilities		159	89
Deferred tax liabilities		219	220
Other liabilities	33	9,398	10,765
Total equity		**114,561**	**120,975**
Equity attributable to non-controlling interests		152	165
Equity attributable to owners of the parent		114,409	120,810
Subscribed capital		15,200	15,200
Additional paid-in capital		11	11
Other capital instruments		8,107	8,107
Retained earnings and other reserves		91,091	97,492
Total liabilities and equity		**1,431,810**	**1,329,223**

These interim consolidated financial statements were prepared by the Financial Group of Ceska sporitelna, a.s. and authorized for issue by the Board of Directors on 3 September 2018.

Tomáš Salomon
Chairman of the Board of Directors

Wolfgang Schopf
Vice-chairman of the Board of Directors

III. Consolidated Condensed Statement of Changes in Total Equity

in CZK million	Subscribed capital	Additional paid-in-capital	Retained earnings	Other capital instruments	Cash flow hedge reserve	Available for sale reserve	Fair value reserve	Liability own credit risk reserve	Currency translation	Equity attributable to owners of the parent	Equity attributable to non-controlling interests	Total equity
As of 1 January 2017	**15,200**	**11**	**95,555**	**8,107**	**268**	**2,594**	**–**	**–**	**(171)**	**121,564**	**166**	**121,730**
Dividends paid	–	–	(11,856)	–	–	–	–	–	–	(11,856)	(4)	(11,860)
Other changes	–	–	(13)	–	1	–	–	–	–	(12)	1	(11)
Total comprehensive income	–	–	7,673	–	(559)	(953)	–	–	(16)	6,145	(6)	6,139
Net result for the period	–	–	7,673	–	–	–	–	–	–	7,673	(6)	7,667
Other comprehensive income	–	–	–	–	(559)	(953)	–	–	(16)	(1,528)	–	(1,528)
As of 30 June 2017	**15,200**	**11**	**91,359**	**8,107**	**(290)**	**1,641**	**–**	**–**	**(187)**	**115,841**	**157**	**115,998**
As of 1 January 2018	**15,200**	**11**	**98,003**	**8,107**	**(1,933)**	**1,622**	**–**	**–**	**(200)**	**120,810**	**165**	**120,975**
Changes of initial application of IFRS 9	–	–	(981)	–	–	(1,622)	1,372	–	4	(1,227)	–	(1,227)
Restated as of 1 January 2018	**15,200**	**11**	**97,022**	**8,107**	**(1,933)**	**–**	**1,372**	**–**	**(196)**	**119,583**	**165**	**119,748**
Dividends paid	–	–	(12,000)	–	–	–	–	–	–	(12,000)	–	(12,000)
Other changes	–	–	3	–	–	–	–	–	–	3	–	3
Total comprehensive income	–	–	7,870	–	(723)	–	(338)	2	12	6,823	(13)	6,810
Net result for the period	–	–	7,870	–	–	–	–	–	–	7,870	(13)	7,857
Other comprehensive income	–	–	–	–	(723)	–	(338)	2	12	(1,047)	–	(1,047)
Change in fair value reserve	–	–	–	–		–	(338)	–	–	(338)	–	(338)
Change in cash flow hedge reserve	–	–	–	–	(723)	–	–	–	–	(723)	–	(723)
Change in currency translation reserve	–	–	–	–	–	–	–	–	12	12	–	12
Fair value changes of financial liabilities at fair value through profit or loss attributable to changes in own credit risk	–	–		–	–	–	–	2	–	2	–	2
As of 30 June 2018	**15,200**	**11**	**92,895**	**8,107**	**(2,656)**	**–**	**1,034**	**2**	**(184)**	**114,409**	**152**	**114,561**

IV. Consolidated Statement of Cash Flows

in CZK million	Notes	1–6 2018	1–6 2017
Pre-tax result from continuing operations		**9,849**	**9,558**
Non-cash adjustments for items in net profit/loss for the year			
Depreciation, amortisation, impairment and reversal of impairment, revaluation of assets		(1,272)	1,030
Allocation to and release of provisions (including credit risk provisions)		(5)	(86)
Gains from the measurement and sale of assets		(435)	–
Gains/(losses) from the sale of assets		–	31
Change in fair values of derivatives		–	(456)
Accrued interest, amortisation of discount and premium		–	(1,775)
Other adjustments		–	342
Changes in assets and liabilities from operating activities after adjustment for non-cash components			
Deposits with the CNB		–	(7,258)
Loans and receivables to credit institutions		–	(3,389)
Loans and receivables to customers		–	(28,836)
Financial assets held for trading		3	(18,062)
Financial assets at fair value through profit or loss		–	56
Non-trading financial assets at fair value through profit or loss			
Debt securities		(15)	–
Loans and advances to customers		2,221	
Financial assets – available for sale: debt instruments		–	22,187
Financial assets at fair value through other comprehensive income: debt instruments		1,681	–
Financial assets held to maturity		–	5,834
Financial assets at amortised cost			
Debt securities		(18,090)	–
Loans and advances to banks		(164,546)	–
Loans and advances to customers		(60,124)	–
Finance lease receivables		(181)	–
Hedge accounting derivatives		403	–
Other assets from operating activities		2,172	1,498
Financial liabilities at amortised costs			
Deposits from banks		70,281	55,841
Deposits from customers		35,193	48,049
Financial liabilities held for trading		328	38,816
Financial liabilities at fair value through profit or loss		132	–
Hedge accounting derivatives		912	
Payments for taxes on income		(1,975)	(1,860)
Other liabilities from operating activities		(552)	1,714
Cash flow from operating activities		**(124,020)**	**123,234**
Financial assets – available for sale: equity instruments		–	127
Financial assets at fair value through other comprehensive income: equity instruments		(177)	–
Proceeds of disposal			
Property and equipment, intangible assets and investment properties		72	119
Acquisition of			
Property and equipment, intangible assets and investment properties		(670)	(525)
Disposal of subsidiaries		–	39
Cash flow from investing activities		**(775)**	**(240)**
Dividends paid to equity holders of the parent		(12,000)	(11,856)
Dividends paid to non-controlling interests		–	(4)
Other financing activities (mainly changes of subordinated liabilities)		–	–
Proceeds from bonds issued		(870)	48
Repurchase of bonds in issue		–	–
Cash flow from financing activities		**(12,870)**	**(11,812)**
Cash and cash equivalents at beginning of period		**280,221**	**149,884**
Cash flow from operating activities		(124,020)	123,234
Cash flow from investing activities		(775)	(240)
Cash flow from financing activities		(12,870)	(11,812)
Effect of currency translation		(2,746)	–
Cash and cash equivalents at end of period	15	**139,810**	**261,066**
Cash flows related to taxes, interest and dividends			
Payments for taxes on income (included in cash flow from operating activities)		(1,975)	(1,860)
Interest received		15,363	13,296
Dividends received		50	47
Interest paid		(2,682)	(2,126)
Dividends paid to equity holders of the parent		(12,000)	(11,860)

V. Consolidated Condensed Notes to the Interim Group Financial Statements of Česká spořitelna a.s.

for the Period from 1 January to 30 June 2018

General information

Česká spořitelna, a.s. ('the Bank'), having its registered office address at Olbrachtova 1929/62, Prague 4, 140 00, Corporate ID 45244782, is the legal successor of the Czech State Savings Bank and was founded as a joint stock company in the Czech Republic on 30 December 1991. The Bank is a universal bank offering retail, corporate and investment banking services within the Czech Republic.

The Bank's majority shareholder is Erste Group Bank AG ('Erste Group Bank'), having its registered office address at Am Belvedere 1, 1100, Vienna. Information on the ultimate parent company's shareholder structure is published in the financial statements of Erste Group Bank AG for the year 2017.

The Bank together with its subsidiaries and associated companies forms the Group. The Group is subject to the regulatory requirements of the Czech National Bank ('CNB'), the banking Act and EU guidelines/regulations. These regulations include those pertaining to minimum capital adequacy requirements, categorization of exposures and off-balance sheet commitments, credit risk connected with clients of the Group, liquidity, interest rate risk, foreign currency positions and operational and other risk.

In addition to the banking entities, other Group companies are subject to regulatory requirements, specifically in relation to retirement, collective investment and brokerage services.

The Group offers a complete range of banking and other financial services, such as savings and current accounts, asset management, consumer credit and mortgage lending, investment banking, securities and derivatives trading, portfolio management, project finance, foreign trade financing, corporate finance, capital and money market services and foreign exchange trading.

Basis of preparation

The condensed consolidated interim financial statements ("interim financial statements") of the Group for the period from 1 January to 30 June 2018 were prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU") and are presented in accordance with the requirements of IAS 34 "Interim Financial Reporting".

The comparative period columns in the 2018 interim financial statements reflect the structure used in 2017 financial statements and present amounts based on the original classification and measurement requirements of IAS 39 (as superseded by IFRS 9) and IFRS 7 (before the consequential amendments resulting from IFRS 9) – for more details see comments in the section Accounting and measurement methods in the text bellow.

The current period columns in the 2018 interim financial statements reflect the new structure of financial statements resulting from the adoption of IFRS 9 - for more details see comments in the section Accounting and measurement methods and in the section Application of new standards (where also financial impact in respect of IFRS 9 transition is commented) in the text bellow.

These interim financial statements were neither audited nor reviewed by an auditor.

Basis of consolidation

Subsidiaries are consolidated from the date upon which control is transferred to the bank. Control is achieved when the bank is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Major additions and disposals in 2018 relevant to number of legal entities and funds included in Česká spořitelna Group's IFRS consolidation scope are as follows:

Additions

Starting June 2018 new company ČS NHQ, s.r.o. was included in Česká spořitelna Group's IFRS consolidation scope.

Disposals

In April 2018 the liquidation of the entity ČS do domu, a.s. v likvidaci was finalized and the entity was deleted from the commercial register.

Accounting and measurement methods

The interim financial statements do not include all the information and disclosures required in the annual consolidated financial statements.

However, due to the first application of IFRS 9 (as described below) the Group has decided to disclose the full set of accounting policies in these interim financial statements. Also, new notes have been introduced in connection with the IFRS 9 application. Otherwise, the interim financial statements should be read in conjunction with the Group's consolidated financial statements as of 31 December 2017.

When preparing the interim financial statements, management undertakes a number of judgements, estimates and assumptions about recognition and measurement of assets, liabilities, income and expenses. The judgements, estimates and assumptions applied in the interim financial statements, including the key sources of estimation uncertainty, were the same as those applied in the Group's last annual consolidated financial statements for the year ended 31 December 2017.

Application of new standards IFRS 9 Financial Instruments

As of 1 January 2018 the Group has adopted IFRS 9 Financial Instruments as endorsed by the EU in November 2016. This resulted in changes in accounting policies for classification and measurement of financial assets and financial liabilities, as well as for impairment of financial assets. IFRS 9 also significantly amends IFRS 7 Financial instruments: Disclosures due to which disclosures of information on financial instruments have been adapted to the new requirements.

As permitted by the transitional provisions of IFRS 9, the Group elected not to restate comparative amounts for the previous financial year 2017. As a result, the comparative period columns in the 2018 interim financial statements reflect the structure used in 2017 financial statements. Also, the comparative period disclosures in the notes are based on the original classification and measurement requirements of IAS 39 (as superseded by IFRS 9) and IFRS 7 (before the consequential amendments resulting from IFRS 9). Due to this fact, accounting policies relevant for financial instruments in accordance with IAS 39 are also disclosed. As allowed by IFRS 9, the Group has elected to continue applying hedge accounting requirements of IAS 39.

The financial impact of IFRS 9 adoption is detailed below.

The tables make use of the following acronyms:
AC – amortised cost
AFS – available for sale
FV – fair value
FVO – fair value option
FVOCI – fair value through other comprehensive income
FVPL – fair value through profit or loss
HTM – held-to-maturity
L&R – loans and receivables
OCI – other comprehensive income

i. Classification and measurement of financial instruments

The table below presents changes between measurement categories and carrying amounts of financial assets and financial liabilities under IAS 39 and IFRS 9 as at 1 January 2018.

As required by IFRS 9 financial impact from IFRS 9 adoption (i.e. from revaluation and remeasurement of financial assets and liabilities originally measured and classified based on IAS 39) is booked against total equity (retained earnings or OCI).

To illustrate the transition impact, the effects are disclosed in respect of original statement of financial position positions reflecting IAS 39 requirements.

		Original classification under IAS 39				
in CZK million	**Com-ments**	**Portfolio**	**Measurement method**	**New classification under IFRS 9**	**Original carrying amount under IAS 39**	**New carrying amount under FRS 9**
Financial assets						
Cash and cash balances		Loans and receivables	AC	Amortised cost	280,221	280,209
Derivatives		Held-for-trading	FVPL	Held-for-trading (FVPL)	11,301	11,301
Other trading assets		Held-for-trading	FVPL	Held-for-trading (FVPL)	132	132
Derivatives hedge accounting		Hedge accounting	FV	Hedge accounting	613	613
Loans and receivables to credit institutions		Loans and receivables	AC	Amortised cost	157,525	157,518
				Amortised cost	634,539	633,310
		Loans and receivables	AC	Mandatorily at FVPL	2,223	2,223
Loans and receivables to customers		Loans and receivables	Finance Lease	Finance Lease	1,932	1,927
				Amortised cost	1,058	1,023
				Mandatorily at FVPL	307	307
Financial assets – available for sale (Debt securities)	a	AFS	FVOCI	FVOCI	52,509	52,509
				Mandatorily at FVPL	380	380
Financial assets – available for sale (Equity instruments)	a	AFS	FVOCI	FVOCI	1,029	1,029
Financial assets – held to maturity		Held-to-maturity	AC	Amortised cost	163,679	163,642
				Mandatorily at FVPL	118	118
Financial assets – at fair value through profit or loss		FV option	FVPL	Designated at FVPL	289	289
Total financial assets					**1,307,855**	**1,306,530**
Financial liabilities						
Derivatives		Held-for-trading	FVPL	Held-for-trading (FVPL)	11,414	11,414
Derivatives – hedge accounting		Hedge accounting	FV	Hedge accounting	1,813	1,813
Financial liabilities measured at amortised cost		Amortised cost	AC	Amortised cost	1,179,929	1,179,929
Financial liabilities – at fair value through profit or loss (Deposits from customers)		FV option	FVPL	Designated at FVPL	1,240	1,240
Total financial liabilities					**1,194,396**	**1,194,396**

(a) The original carrying amount under IAS 39 is adjusted by CZK 307 million in respect of debt securities and equity securities compared to the 2017 financial statements due to a reclassification between debt and equity instruments related to investments in funds. More details can be found in the comment (e) to table ii. Reconciliation of carrying amounts of financial assets is based on measurement categories.

ii. Reconciliation of carrying amounts of financial assets based on measurement categories

in CZK million	Com-ments	IAS 39 carrying amount 31 Dec 17	Reclassi-fications	Remeas-urement	IFRS 9 carrying amount 1 Jan 18	Retained earnings effects	OCI effects
Amortised cost	a	**1,240,119**	**–**	**–**	**1,240,119**	**–**	**–**
Additions:							
from IAS 39 FVOCI (AFS) – debt securities	b	–	1,058	(35)	1,023	(1)	(34)
from IAS 39 AC (L&R, HTM) (impairment remeasurement)		–	–	(1,290)	(1,290)	(1,290)	–
Subtractions:		–					
to IFRS 9 Mandatorily at FVPL (IAS 39: L&R) – loans and advances to customers	c	–	(2,223)	–	(2,223)	–	–
Total change		–	(1,165)	(1,325)	(2,490)	(1,291)	(34)
Total – amortised cost	d	**1,240,119**	**(1,165)**	**(1,325)**	**1,237,629**	**(1,291)**	**(34)**
Fair value through other comprehensive income		**55,283**	**–**	**–**	**55,283**	**–**	**–**
Fair value through other comprehensive income – debt securities	e	**53,874**	**–**	**–**	**53,874**	**–**	**–**
Additions:							
from IAS39 AFS (impairment remeasurement)						(104)	104
Subtractions:							
to IFRS 9 AC (IAS 39: AFS)	b	–	(1,058)	–	(1,058)	–	–
to IFRS 9 Mandatorily at FVPL (IAS 39: AFS)	f	–	(307)	–	(307)	–	–
Subtotal change – debt securities at FVOCI		**–**	**(1,365)**	**–**	**(1,365)**	**(104)**	**104**
Subtotal – debt securities at FVOCI		**53,874**	**(1,365)**	**–**	**52,509**	**(104)**	**104**
Fair value through other comprehensive income – equity instruments	e	**1,409**	**–**	**–**	**1,409**	**–**	**–**
Subtractions:				–			
to IFRS 9 FVPL (IAS 39: AFS)	g	–	(380)	–	(380)	–	–
Subtotal change – equity instruments at FVOCI		**–**	**(380)**	**–**	**(380)**	**–**	**–**
Subtotal – equity instruments at FVOCI		**1,409**	**(380)**	**–**	**1,029**	**–**	**–**
Total change		**–**	**(1,745)**	**–**	**(1,745)**	**(104)**	**104**
Total – fair value through other comprehensive income		**55,283**	**(1,745)**	**–**	**53,538**	**(104)**	**104**
				–			
Fair value through profit or loss	h	**11,840**	**–**	**–**	**11,840**	**–**	**–**
Additions:				–			
from IAS 39 AC (L&R) (IFRS 9: Mandatorily at FVPL) – loans and advances to customers	c	–	2,223	–	2,223	–	–
from IAS 39 FVOCI (AFS) (IFRS 9: Mandatorily at FVPL) – debt instruments	f	–	307	–	307	94	(94)
from IAS 39 FVOCI (AFS) – equity instruments	g	–	380	–	380	287	(287)
Total change		**–**	**2,910**	**–**	**2,910**	**381**	**(381)**
Total – fair value through profit or loss	i	**11,840**	**2,910**	**–**	**14,750**	**381**	**(381)**
Total – financial assets		**1,307,242**	**–**	**(1,325)**	**1,305,917**	**(1,014)**	**(311)**

(a) The amount includes IAS 39 statement of financial position line items with following carrying amounts in CZK million:

– cash and cash balances: 280,221;

– loans and receivables to credit institutions: 157,525;

– loans and receivables to customers: 636,762;

– finance lease receivables 1,932 and
– financial assets – held to maturity: 163,679.

(b) Debt securities that were classified as available for sale and measured at FVOCI under IAS 39 and that are part of the portfolios connected to asset and liability management activities were reclassified to the amortised cost measurement category under IFRS 9 due to the business model of holding the assets to collect contractual cash flows.

(c) The reclassification relates largely to loans to customers that are not part (based on IFRS 9) of the business model of holding the assets to collect contractual cash flows and thus have to be measured at FVPL.

(d) The IFRS 9 carrying amount as at 1 January 2018 includes IFRS 9 statement of financial position line items with following carrying amounts in CZK million:
– cash and cash balances 280,209;
– financial assets at amortised cost:
  a) debt securities: 167,304;
  b) loans and advance to credit institutions: 155,654;
  c) finance lease receivables: 1,927 and
  d) loans and advances to customers: 632,535.

(e) The carrying amount of debt securities at FVOCI (AFS under IAS 39) also includes:
Investments in funds with a carrying amount of CZK 307 million that until 2017 were treated as equity instruments in the financial statements. Emphasis was put on their economic substance of being equity security-like. From 2018 Group has started to classify them as debt instruments. Preference is put on the puttable feature due to which they meet the definition of a liability in accordance with IAS 32. Thus, they are debt instruments both from the issuer and the investor perspective. In the transition disclosures they are treated as debt instruments also in respect of the IAS 39 carrying amount.
As a result, the reclassification between the debt and equity instruments also impacted the carrying amount of equity instruments at FVOCI (AFS under IAS 39) which, compared to the amount presented in the 2017 financial statements, is decreased by the above amounts in the transition disclosures.

(f) The cases of reclassifications of debt instruments from the available for sale category measured at FVOCI under IAS 39 to the mandatorily at FVPL category under IFRS 9 were:
– investments in funds that are not consolidated by Group with a carrying amount of CZK 307 million reclassified due to the assets having contractual cash flows that are not SPPI.

(g) The reclassification in amount of CZK 380 million from the available for sale category under IAS 39 to the fair value through profit or loss category under IFRS 9 relates to those investments in equity instruments that are not held for trading and that were not designated as measured at FVOCI upon the transition to IFRS 9.

(h) The amount includes IAS 39 statement of financial position line items with following carrying amounts in CZK million:
– derivatives – held for trading: 11,301;
– other trading assets: 132; and
– financial assets – at fair value through profit or loss: 407.

(i) The IFRS 9 carrying amount of the item Fair value through profit or loss as at 1 January 2018 includes IFRS 9 statement of financial position line items with following carrying amounts in CZK million:
– derivatives – held for trading: 11,301;
– other trading assets: 132;
– non-trading financial assets at FVPL:
  a) equity instruments mandatorily at FVPL: 380;
  b) debt instruments mandatorily at FVPL: 425;
  c) debt instruments designated at FVPL: 289, and
  d) loans and advances to customers mandatorily at FVPL: 2,223.

iii. Reconciliation of carrying amounts of financial liabilities based on measurement categories

in CZK million	Com-ments	IAS 39 carrying amount 31 Dec 17	Reclassi-fications	Remeas-urement	IFRS 9 carrying amount 1 Jan 18	Retained earnings effects	OCI effects
Amortised cost	a	1,179,929	–	–	1,179,929	–	–
Total change		–	–	–	–	–	–
Total – amortised cost	a	1,179,929	–	–	1,179,929	–	–
			–	–		–	–
Fair value through profit or loss	b	12,654	–	–	12,654	–	–
Total change		–	–	–	–	–	–
Total – fair value through profit or loss	b	12,654	–	–	12,654	–	–
Total – financial liabilities		1,192,583	–	–	1,192,583	–	–

(a) The original carrying amount under IAS 39 in the line 'Amortised cost' captures financial liabilities that continue to be measured at amortised cost. The original carrying amount under IAS 39 and the IFRS 9 carrying amount as at 1 January 2018 in the line 'Amortised cost' include statement of financial position line items with following carrying amounts in CZK million:
– deposits from customers: 881,997;
– deposits from banks: 295,232;
– debt securities issued: 1,805; and
– Other financial liabilities: 895.

(b) The original carrying amount under IAS 39 loss' and the IFRS 9 carrying amount as at 1 January 2018 in the line 'Fair value through profit or loss' include statement of financial position line items with following carrying amounts in CZK million:
– derivatives – held for trading: 11,414;
– financial liabilities – at fair value through profit or loss:
  a) deposits from customers: 1,240.

iv. Reconciliation of impairment allowances

The following table reconciles the amounts of loss allowances as at 31 December 2017 based on the IAS 39 incurred loss impairment model with the amounts as at 1 January 2018 subject to the IFRS 9 expected credit loss impairment model:

in CZK million	IAS 39 / IAS 37 carrying amount 31 Dec 17	Reclassifications	Remeasurement	IFRS 9 carrying amount 1 Jan 18
Debt instruments at AC	(12,326)	–	(1,679)	(14,005)
Debt instruments at FVOCI	–	(104)	–	(104)
Finance lease	(114)	–	(30)	(144)
Off balance-sheet exposures (loan commitments and guarantees given)	(784)	–	(130)	(914)
Total	**(13,224)**	**(104)**	**(1,839)**	**(15,167)**

The column Reclassifications relates to changes in impairment allowances due to differences in the scope of requirements between IFRS 9 and IAS 39. As a result, the increase in impairment due to reclassifications amounting to CZK 104 million:
– relates mainly to loss allowances newly recognised on 1 January 2018 of CZK 104 million in respect of former AFS debt securities classified at FVOCI under IFRS 9. However this change did not impact the group equity upon transition to IFRS 9.

The column Remeasurement relates to changes in impairment allowances that were (under IAS 39 for financial assets and under IAS 37 for off-statement of financial position credit risk bearing exposures) and continue to stay (under IFRS 9) in the impairment calculation scope. In this respect:
– the line 'Debt instruments at AC' captures differences in loss allowances for debt instruments measured at amortised cost under IFRS 9 that were previously classified as loans and receivables (other than trade and other receivables) and held-to-maturity in accordance with IAS 39.

Further, the increase in impairment allowances amounting to CZK 1,839 million attributable to remeasurement includes following special effects that did not impact the group equity upon transition to IFRS 9:

– an increase of CZK 404 million representing additional impairment allowances against credit-impaired loans ('Stage 3') in respect of which interest receivables accruing after default were 'suspended' off-balance up to 31 December 2017 but were re-integrated in the on-balance gross carrying amounts of the related assets as of 1 January 2018 as required by IFRS 9.

As a result, the impairment remeasurements had a negative impact on the group retained earnings amounting to CZK 1,014 million. Overall, the reclassifications and remeasurements impairment effects decreased the group equity by CZK 1,325 million.

v. Deferred tax effects upon transition to IFRS 9

The following table illustrates the effects of IFRS 9 on the carrying amount of deferred tax assets and deferred tax liabilities:

in CZK million	IAS 39 carrying amount 31 Dec 17	IFRS 9 carrying amount 1 Jan 18	Retained earnings effects	OCI effects
Changes in deferred tax assets	1,000	1,226	169	57
Changes in deferred tax liabilities	(220)	(214)	4	2

Significant accounting policies

Financial instruments

A financial instrument is any contract giving rise to a financial asset of one party and a financial liability or equity instrument of another party. In accordance with IFRS 9 (as well as IAS 39), all financial assets and liabilities – which also include derivative financial instruments – have to be recognised in the statement of financial position and measured in accordance with their assigned categories.

Measurement methods for financial instruments

Measurement of financial assets and financial liabilities is subject to two primary measurement methods.

i. Amortised cost and effective interest rate

Amortised cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount. For financial assets the amount is adjusted for any loss allowance.

The effective interest rate ("EIR") is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of the financial asset (i.e. its amortised cost before adjusting for any loss allowance) or to the amortised cost of the financial liability. The estimated cash flows consider all the contractual terms of the financial instrument but disregard the expected credit losses. The calculation includes transaction costs, origination fees that are an integral part of the EIR (apart from financial instruments at fair value through profit or loss) and all other premiums and discounts to the par amount.

For purchased or originated credit-impaired financial assets ("POCI", see part 'Impairment of financial instruments under IFRS 9') credit-adjusted EIR is used. It is the rate that exactly discounts the estimated future cash flows which consider expected credit losses to the amortised cost of a financial asset.

The EIR is used for recognition of interest income and interest expense. Interest income is calculated in the following way:

- EIR applied to the gross carrying amount for financial assets which are not credit-impaired (Stage 1 and Stage 2, see part 'Impairment of financial instruments');
- EIR applied to the amortised cost for financial assets which are credit-impaired (Stage 3, see part 'Impairment of financial instruments'); and
- credit-adjusted EIR applied to the amortised cost for POCI financial assets.

Under IAS 39 the EIR is applied to the gross carrying amount of the financial assets and, for financial assets which are individually impaired, to the amortised cost.

Interest expense is calculated by applying the effective interest rate to the amortised cost of a financial liability.

ii. Fair value

Fair value is the price that would be received if an asset were sold or paid, if a liability were transferred in an orderly transaction between market participants on the measurement date. The definition also applies to fair value measurements of non-financial assets and liabilities. Details on valuation techniques applied for fair value measurement and on the fair value hierarchy are disclosed in Note 37 Fair value of financial instruments.

Initial recognition and measurement

i. Initial recognition

Financial instruments are initially recognised when the Group becomes a party to the contractual provisions of the instrument. Regular way (spot) purchases and sales of financial assets stated at fair value are recognised at trade date and at settlement date for financial assets not stated at fair value. Regular way trades are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

ii. Initial measurement

Financial instruments are measured initially at their fair value including transaction costs. In the case of financial instruments at fair value through profit or loss, however, transaction costs are not included but are recognised directly in profit or loss. Subsequent measurement is described below.

Classification and subsequent measurement of financial assets under IFRS 9

In accordance with IFRS 9, the classification and subsequent measurement of financial assets depend on the following two criteria:

(i) the business model for managing the financial assets – the assessment is focused on whether the financial asset is part of a portfolio where the assets are held in order to collect contractual cash flows, to both collect the contractual cash flows and sell the assets or they are held in other business models.

(ii) the cash flow characteristics of the financial assets – the assessment is focused on whether the contractual terms of the financial asset give rise on specified dates to cash flows that are

solely payments of principal and interest ("SPPI") on the principal amount outstanding.

i. Financial assets at amortised cost

Financial assets are measured at amortised cost if they are held in a business model whose objective is to collect contractual cash flows and their contractual cash flows are SPPI.

In the statement of financial position, these assets are carried at amortised cost, i.e. the gross carrying amount net of the credit loss allowance. They are presented under the line 'Financial assets at amortised cost', 'Trade and other receivables' and 'Cash and cash balances'. Cash balances include only claims (deposits) against central banks and credit institutions that are repayable on demand. Repayable on demand means that they may be withdrawn at any time or with a term of notice of only one business day or 24 hours. Mandatory minimum reserves are also shown under this item.

Interest income on these assets is calculated by effective interest method and is included under the line 'Net interest income' (sub-item "Interest income") in the statement of income. Impairment gains or losses are included in the line 'Impairment result from financial instruments'. Gains and losses from derecognition (such as sales) of the assets are reported under the line item 'Gains/losses from derecognition of financial assets measured at amortised cost'.

At the Group financial assets at amortised cost constitute the largest measurement category which includes the vast majority of loan business to customers (except for certain loans measured at fair value through profit or loss), interbank lending business (including reverse repo transactions), deposits with central banks, amounts in the course of settlement, trade and other receivables. Investments in debt securities measured at amortised cost may be acquired with different business objectives (such as fulfilling internal/external liquidity risk requirements and efficient placement of the structural liquidity surplus, strategic positions decided by the board of directors, initiation and fostering of client relationship, substitution of loan business or other yield enhancement activities). Their common attribute is that significant and frequent sales of such securities are not expected. For a description of what sales are considered as compliant with the held to collect contractual cash flows business model see the "Business model assessment" part in chapter Significant accounting judgements, assumptions and estimates.

ii. Financial assets at fair value through other comprehensive income

Debt instrument financial assets are measured at fair value through other comprehensive income (FVOCI) if their contractual cash flows are SPPI compliant and they are held within a business model whose objective is achieved by both to collect contractual cash flows and sell the assets. In the statement of financial position they are included as 'Debt securities' under the line 'Financial asset at fair value through other comprehensive income'.

Interest income on these assets is calculated using the effective interest method and is included under the line 'Net interest income' (sub-item "Interest income") in the statement of income. Impairment gains and losses are recognised in profit or loss in the line 'Impairment result from financial instruments'.

The difference between the fair value at which the assets are carried in the statement of financial position and the amortised cost component is recognised as accumulated OCI in equity specifically under 'Fair value reserve' in the statement of changes in equity. The change for the period is reported as OCI in the statement of comprehensive income in the line 'Debt instruments at fair value through other comprehensive income'. When the financial asset is derecognised the amount previously accumulated in OCI is reclassified to profit or loss and reported under the line 'Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss'.

For certain investments in equity instruments which are not held for trading, the Group makes use of the option to measure them at FVOCI. This election is applied to strategic, significant banking business relationship investments. The fair value gains or losses for the period are reported as OCI in the line 'Fair value changes of equity instruments' of the statement of comprehensive income. The cumulative gains or losses are included under 'Fair value reserve' in the statement of changes in equity. The amount recognised in OCI is never reclassified to profit or loss. Dividends received on these investments are reported under the line 'Dividend income' of the statement of income. In the statement of financial position financial assets measured at fair value through OCI are included as 'Equity instruments' under the line 'Financial asset at fair value through other comprehensive income'.

iii. Financial assets at fair value through profit or loss

There are different reasons for assigning the fair value through profit or loss (FVPL) measurement category to financial assets.

Financial assets whose contractual cash flows are not considered as SPPI are mandatorily measured at FVPL.

Other source of FVPL measurement relates to financial assets which are part of residual business models, i.e. they are neither held to collect contractual cash flows, nor held either to collect contractual cash flows, or sell the assets. These financial assets are generally expected to be sold before their maturity or they are managed and their performance is evaluated on a fair value basis. In the business of the Group, such business models are typical of assets which are held for trading (i.e. financial assets held by the trading function of the bank), of assets whose value is expected to be primarily realised through sales.

The Group also utilizes the option to designate some financial assets as measured at FVPL at initial recognition. Such a classification is used if it eliminates or significantly reduces an accounting mismatch between the financial asset, which in the absence of such a classification would be measured at amortised cost or at FVOCI, and the related derivative measured at FVPL.

In the statement of financial position, debt instrument financial assets measured at FVPL are presented as 'Financial assets held for trading', sub-item 'Other financial assets held for trading' and 'Non-trading financial assets at fair value through profit or loss', (sub-items 'Debt securities', 'Loans and advances to banks' and 'Loans and advances to customers'). Non-trading financial assets consist of two sub-categories disclosed in Note 19 which are 'mandatorily at fair value through profit or loss' and 'designated at fair value through profit or loss'. Financial assets are mandatorily measured at fair value through profit or loss either because their contractual cash flows are not SPPI or they are held as part of residual business models that are other than held for trading.

Investments in equity instruments which are held for trading (i.e. financial assets held by the trading function of the bank) are measured at FVPL. They are included in the statement of financial position under the line 'Financial assets held for trading', sub-item 'Other financial assets held for trading'. Investments in equity instruments which are not held for trading are also measured at FVPL (unless they are designated at FVOCI). They are presented in the statement of financial position under "Non-trading financial assets at fair value through profit or loss", sub-item "Equity instruments", sub-category "mandatorily at fair value through profit or loss" in Note 19.

In the statement of income, the profit or loss effects of financial assets measured at FVPL are split into interest income or dividend income and fair value gains and losses. The interest income on debt instruments is presented in the line 'Net interest income' (sub-item "Other similar income"). The dividend income on equity instruments is presented in the line 'Dividend income'. The fair value gains or losses are calculated net of the interest or dividend income. They are reported in the line 'Net trading result' for financial assets held for trading and in the line 'Gains/losses from financial instruments measured at fair value through profit or loss' in case of non-trading financial assets at FVPL.

Classification and subsequent measurement of financial liabilities under IFRS 9

Financial liabilities are classified as measured at amortised cost unless they are measured at fair value through profit or loss.

i. Financial liabilities at amortised cost

For presentation in the statement of financial position, the line item 'Financial liabilities measured at amortised cost' is used. The liabilities are further broken down into 'Deposits from banks', 'Deposits from customers', 'Debt securities issued' and 'Other financial liabilities'.

Interest expenses incurred are reported in the line item 'Net interest income' (sub-item "Interest expenses") in the statement of income. Gains and losses from de-recognition (mainly repurchase) are reported under the line item 'Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss'.

ii. Financial liabilities at fair value through profit or loss

Financial liabilities at FVPL consist of financial liabilities held for trading and financial liabilities designated at FVPL.

Non-derivative financial liabilities held for trading are those which are incurred principally for the purpose of repurchasing them in the near term. In the business of the Group non-derivative held-for-trading liabilities comprise of short sales. These arise from obligations to return securities, which are purchased under agreements to resell or are borrowed through securities lending transactions and subsequently sold to third parties. In the statement of financial position such liabilities are presented under the line 'Financial liabilities held for trading', sub-item 'Other financial liabilities'. The gains or losses on financial liabilities held for trading are reported in the line 'Net trading result' in the statement of income.

Furthermore, the Group makes use of the option to designate some financial liabilities as measured at FVPL at initial recognition (referred to as fair value option) if:

- such classification eliminates or significantly reduces an accounting mismatch between the financial liability otherwise measured at amortised cost and the related derivative measured at fair value; or
- the entire hybrid contract is designated at fair value through profit or loss due to the existence of an embedded derivative.

Financial liabilities designated at fair value through profit or loss are reported in the statement of financial position under the line item 'Financial liabilities designated at fair value through profit or loss' further broken down into 'Deposits from customers' and 'Debt securities issued'.

Changes in fair value are recognised in the income statement under the line item 'Result from financial assets and liabilities designated at fair value through profit or loss'. Interest incurred is reported under the line item 'Net interest income' (sub-item "Other similar expenses").

The amount of the fair value change resulting from the credit risk of the financial liability for the period is presented as OCI in the statement of comprehensive income in the line 'Fair value changes of financial liabilities at fair value through profit or loss attributable to changes in their own credit risk'. The cumulative amount is recognised as accumulated OCI, specifically under 'Liability own credit risk reserve' in the statement of changes in equity. The cumulative amount is calculated as the difference between the present value of the liability determined by using the original credit spread and the fair value of the liability. When calculating the present value of the liability by using the original credit spread the rate used for discounting is the sum of the observed interest rate (swap yield curve) and the original credit spread. The original credit spread is determined at initial recognition of the liability and it equals the difference between the total yield of the liability and the observed interest rate (swap yield curve) at that time. For the purpose of calculation of the present value of the liability, the original credit spread remains fixed over the whole life of

the liability. The amount of fair value change attributable to changes in credit risk of the liability for the period which is recognised in OCI is the difference between the cumulative amount of the credit risk at the end of the period and at the beginning of the period.

Classification, subsequent measurement and statement of financial position line items of financial instruments under IAS 39

As regards the comparative period information on financial instruments in accordance with IAS 39, Group uses the following categories of financial instruments:

- financial assets or financial liabilities at fair value through profit or loss;
- available-for-sale financial assets;
- held-to-maturity investments;
- loans and receivables; and
- financial liabilities measured at amortised cost.

The line items as presented in the statement of financial position do not necessarily correspond with the IAS 39 categories of financial instruments. The correspondence between the statement of financial position line items and the categories of financial instruments is described in the table at item (x).

i. Cash and cash balances in the comparative period

Balances with central banks include only claims (deposits) against central banks and credit institutions which are repayable on demand. Repayable on demand means that it may be withdrawn at any time or with a term of notice of only one business day or 24 hours. Mandatory minimum reserves are also shown under this position.

The Group considers cash and deposits with the CNB, treasury bills and treasury bonds with a residual maturity of three months or less and nostro and loro accounts with financial institutions to be cash equivalents.

ii. Derivative financial instruments in the comparative period

Please refer to the part 'Derivative financial instruments' below.

iii. Financial assets and financial liabilities – held for trading in the comparative period

Financial assets and financial liabilities – held for trading comprise derivatives and other trading assets and liabilities. Treatment of derivatives – held for trading is discussed below.

Other trading assets and liabilities are non-derivative instruments. They include debt securities as well as equity instruments acquired or issued principally for the purpose of selling or repurchasing in the near term. In the statement of financial position, they are presented as 'Other trading assets' or 'Other trading liabilities' under the heading 'Financial assets / financial liabilities – held for trading'.

Changes in fair value (clean price for debt instruments) resulting from other trading assets and liabilities are reported in the income statement under the line item 'Net trading result'. Interest income and expenses are reported in the income statement under the line item 'Net interest income' (sub-items "Other similar income" or "Other similar expenses"). Dividend income is shown under the line item 'Dividend income'.

If securities purchased under agreement to resell or borrowed through securities lending transactions are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within 'Other trading liabilities'.

iv. Financial assets or financial liabilities designated at fair value through profit or loss in the comparative period

Financial assets or financial liabilities classified in this category are those that have been designated by management on initial recognition (fair value option).

The Group uses the fair value option in the case of financial assets managed on a fair value basis. In accordance with a documented investment strategy, the performance of the portfolio is evaluated and regularly reported to the management board. The portfolio contains mostly items of Funds, Financials and Sovereigns.

Financial assets – designated at fair value through profit or loss are recorded in the statement of financial position at fair value under the line item 'Financial assets – designated at fair value through profit or loss', with changes in fair value recognised in the income statement under the line item '' Result from financial assets and liabilities designated at fair value through profit or loss'. Interest earned on debt instruments is reported under the line item 'Net interest income'(sub-items "Other similar income" or "Other similar expenses"). Dividend income on equity instruments is shown under the line item 'Dividend income'.

Furthermore, the Group uses the fair value option in case of some hybrid financial liabilities. This is relevant when:

- such classification eliminates or significantly reduces an accounting mismatch between the financial liability otherwise measured at amortised cost and the related derivative measured at fair value; or
- the entire hybrid contract is designated at fair value through profit or loss due to the existence of an embedded derivative.

Financial liabilities designated at fair value through profit or loss are reported in the statement of financial position under the line item 'Financial liabilities designated at fair value through profit or loss' further broken down into 'Deposits from customers' and 'Debt securities issued'. Changes in fair value are recognised in the income statement under the line item 'Result from financial assets and liabilities designated at fair value through profit or loss'. Interest incurred is reported under the line item 'Net interest income' (sub-item "Other similar expenses").

v. Financial assets – available for sale in the comparative period

Available-for-sale financial assets include debt and equity securities as well as other interests in entities with lower than significant influence. Equity investments classified as available for sale are those that are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in market conditions.

Available-for-sale financial assets are measured at fair value. In the statement of financial position, available-for-sale financial assets are disclosed under the line item 'Financial assets – available for sale'.

Unrealised gains and losses are recognised in other comprehensive income and reported in the 'Available for sale reserve' until the financial asset is disposed of or impaired. If available-for-sale assets are disposed of or impaired, the cumulative gain or loss previously recognised in other comprehensive income is reclassified to profit or loss and reported in the line item 'Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net' in case of sale or in the line item 'Net impairment loss on financial assets' in case of impairment.

Interest income on available-for-sale financial assets is reported under the line item 'Net interest income' (sub-item "Interest income"). Dividend income is reported under the line item 'Dividend income'.

If the fair value of investments in non-quoted equity instruments cannot be measured reliably, they are recorded at cost less impairment. This is the case when the range of reasonable fair value estimates as calculated by valuation models is significant and the probabilities of the various estimates cannot be reasonably assessed. There is no market for such investments. In 2017, as part of IFRS 9 implementation, valuation models for investments in unquoted equities were developed. The Bank considers that these models deliver reliable fair value measurement. As a result, these investments were remeasured to fair value throughout 2017.

vi. Financial assets – held to maturity in the comparative period

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity and reported in the statement of financial position as 'Financial assets – held to maturity' if the Group has the intention and ability to hold them until maturity. After initial recognition, held-to-maturity financial assets are measured at amortised cost. Amortised cost is calculated by taking into account any discount, premium and/or transaction costs that are an integral part of the effective interest rate.

Interest earned on financial assets held to maturity is reported in the income statement under the line item 'Net interest income' (sub-item "Interest income"). Losses arising from impairment of such financial assets are presented as 'Net impairment loss on financial assets'. Occasional realised gains or losses from selling are recognised in the income statement under the line item 'Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net'.

vii. Loans and receivables in the comparative period

The statement of financial position line items 'Loans and receivables to credit institutions' and 'Loans and receivables to customers' include financial assets meeting the definition of loans and receivables. Furthermore, finance lease receivables that are accounted for using IAS 17 are presented under these statement of financial position line items.

Loans and receivables are non-derivative financial assets (including debt securities) with fixed or determinable payments that are not quoted in an active market, other than:

- those that the Group intends to sell immediately or in the near term and those that the Group upon initial recognition designates as at fair value through profit or loss;
- those that the Group, upon initial recognition, designates as available for sale; or
- those for which the Group may not recover substantially all of its initial investment, other than because of credit deterioration.

After initial recognition, loans and receivables are measured at amortised cost. Finance lease receivables are subsequently measured as specified in the chapter 'Leasing'. Interest income earned is included under the line item 'Net interest income' (sub-item "Interest income") in the income statement. Impairment losses arising from loans and receivables are recognised in the income statement under the line item 'Net impairment loss on financial assets'.

viii. Financial liabilities measured at amortised cost in the comparative period

Financial liabilities are measured at amortised cost, unless they are measured at fair value through profit or loss.

For presentation in the statement of financial position the line item 'Financial liabilities measured at amortised cost' is used. The liabilities are further broken down by 'Deposits from banks', 'Deposits from customers', 'Debt securities issued' and 'Other financial liabilities'.

Interest expenses incurred are reported in the line item 'Net interest income' (sub-item "Interest expenses") in the income statement. Gains and losses from derecognition (mainly repurchase) of financial liabilities at amortised cost are reported under the line item 'Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net'.

ix. 'Day 1' profit

Where the transaction price differs from the fair value derived from other observable transactions for the identical instrument in active market or derived using valuation technique that has all significant inputs based on observable markets data, the Group immediately recognises the difference between the transaction price and the fair value (a Day 1 profit) in the income statement in line item 'Net trading result'.

x. Relationships between statement of financial position items, measurement methods and categories of financial instruments in the comparative period:

Statement of financial position	Measurement principle			Financial instrument category
	Fair value	At amortised cost	Other	
Assets				
Cash and cash balances		x	Nominal value	n/a
Financial assets – held for trading				
Derivatives	x			Financial assets at fair value through profit or loss
Other trading assets	x			Financial assets at fair value through profit or loss
Financial assets – designated at fair value through profit or loss	x			Financial assets at fair value through profit or loss
Financial assets – available for sale	x			Available for sale financial assets
Financial assets – held to maturity		x		Held to maturity investments
Loans and receivables to credit institutions		x		Loans and receivables
Loans and receivables to customers		x		Loans and receivables
Derivatives – hedge accounting	x			n/a
Liabilities and equity				
Financial liabilities – held for trading				
Derivatives	x			Financial liabilities – at fair value through profit or loss
Other trading liabilities	x			Financial liabilities – at fair value through profit or loss
Financial liabilities – designated at fair value through profit or loss	x			Financial liabilities – at fair value through profit or loss
Financial liabilities measured at amortised cost		x		Financial liabilities measured at amortised cost
Derivatives – hedge accounting	x			n/a

Furthermore, two additional classes of financial instruments which are not presented in the table above are part of IFRS 7 disclosures. These are financial guarantees and irrevocable credit commitments.

Impairment of financial instruments under IFRS 9

The Group recognises loss allowances for impairment on its debt instrument financial assets, other than those measured at FVPL, its lease receivables and its off-balance credit risk exposures arising from financial guarantees and certain loan commitments.

The impairment is based on expected credit losses whose measurement reflects:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- the time value of money; and
- reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The amount of the impairment loss is recognised as a loss allowance. For the purpose of the measurement of the amount of expected credit loss and recognition of interest income the Group distinguishes between three stages of impairment.

Stage 1 relates to financial instruments for which no significant increase in credit risk has been identified since their initial recognition. The impairment is measured in the amount of the 12-month expected credit loss. Interest income is recognised by effective interest rate applied to the gross carrying amount of the financial asset.

Financial instruments in Stage 2 are subject to significant increase in credit risk since their initial recognition. The impairment is measured in the amount of the lifetime expected credit loss. Interest income is recognised by effective interest rate applied to the gross carrying amount of the financial asset (as for Stage 1).

Financial assets in Stage 3 are credit-impaired. In respect of applying the 'credit-impaired' concept of IFRS 9, the Group generally adopted the approach of aligning it with the regulatory concept (i.e. CRR concept) of 'default' for lending exposures. The impairment for such financial assets is measured in the amount of lifetime expected credit loss. Interest income is recognised by EIR applied to the amortised cost (i.e. the net carrying amount) of the financial asset. From balance sheet perspective, interest is accrued based on the financial assets' gross carrying amount. The difference between the interest accrued on the assets and the interest income recognised is reflected through the allowance account (without impacting the impairment loss). Stage 3 classification is not relevant for loan commitments and financial guarantees.

More detailed information about identification of significant increases in credit risk including collective assessment, estimation techniques used to measure 12-month and lifetime expected credit losses and definition of default is provided in Note 36 Risk management, part Credit risk.

The loss allowances decrease the value of the assets. I.e. for financial assets measured at amortised cost the net carrying amount of the financial asset presented on the balance sheet is the difference between the gross carrying amount and the cumulative loss allowance. However, for financial assets measured at FVOCI the loss allowance is recognised in accumulated OCI, specifically under 'Fair value reserve' in the statement of changes in equity. Loss allowances for loan commitments and financial guarantees are presented under the statement of financial position line item 'Provisions'.

For financial assets which are credit-impaired at initial recognition (purchased or originated credit-impaired – POCI - financial assets) lifetime expected credit losses are initially reflected in the credit-adjusted effective interest rate. As a result, no loss allowance is recognised at inception. Subsequently only adverse changes in lifetime expected credit losses after the initial recognition are recognised as loss allowance, whilst favourable changes are recognised as impairment gains increasing the gross carrying amount of the POCI financial assets. No impairment stages are distinguished for the POCI financial assets.

In the statement of income, impairment losses and their reversals (gains) on all kinds of financial instruments not measured at FVPL are presented in the line item 'Impairment result from financial instruments'.

Impairment of financial assets and credit risk losses of contingent liabilities under IAS 39 in the comparative period

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the Group of financial assets that can be reliably estimated.

The Group uses the Capital requirements regulation ("CRR") definition of default as a primary indicator of loss events. Default, as a loss event, occurs when

- The obligor is more than 90 days past due on any material credit obligation;
- As a result of specific information or an event, the obligor is unlikely to fulfil its credit obligations in full, without recourse to actions such as realising security;
- The obligor is subject to distressed restructuring, i.e. a change in contract terms, for clients in financial difficulties, resulting in a material loss;
- The obligor is subject to bankruptcy or similar protection proceedings.

In order to maximise collection opportunities and minimise the number of defaults, Group renegotiates loans to customers in financial difficulties (referred to as forbearance cases). Both retail and corporate loans can be subject to forbearance. Under the Group's forbearance policy, loan forbearance can be granted if the debtor is currently in default or if there is a high risk of default, there is evidence that the debtor made all efforts to pay according to the original contractual terms and it is expected that the debtor is able to meet the revised terms. Revised terms could be extended maturity, instalment reduction, changing the timing of the interest payments, interest reduction or forgiveness, revolving exposure change to instalments.

Loans subject to forbearance are generally not derecognised and are considered for impairment based on renegotiated conditions. However, if the renegotiation can be qualitatively assessed as a substantial extinguishment of the rights to collect the cash flows due to material changes in the timing and amount of the cash flows the loan is derecognised and the renegotiated loan is recognized as a new loan initially measured at fair value.

For assessment at portfolio level, the Group uses the incurred but not reported losses concept; indications of impairment are observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. It identifies the time period between the moment of the loss event causing future problems and actual detection of the problems by the Group at the moment of default. Credit risk losses resulting from contingent liabilities are recognised if it is probable that there will be an outflow of resources to settle a credit risk bearing contingent liability that will result in a loss.

Write-offs

Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and the possibility of further recovery is considered remote. The loan is written-off against the related account 'Net impairment loss on financial assets not measured at fair value through profit or loss' in the income statement. If the reason for provisioning is no longer deemed appropriate, the redundant impairment charge is released into income. The relevant amount and recoveries of loans and advances previously written-off are also reflected in the income statement through 'Net impairment loss on financial assets not measured at fair value through profit or loss'.

Derecognition of financial instruments including treatment of contractual modifications

i. Derecognition of financial assets

A financial asset (or, where applicable, part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the contractual rights to receive cash flows from the asset have expired; or
- the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement;
- and either:
  - it has transferred substantially all risks and rewards connected with ownership of the asset, or
  - has neither transferred nor retained substantially all risks and rewards connected with ownership of the asset but has transferred control of the asset.

The difference between the carrying amount of the derecognised asset and the consideration received is presented in the statement of income in the line 'Gains/losses from derecognition of financial assets measured at amortised cost' or, for financial assets at FVOCI, in the line 'Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss'. For financial assets measured at FVPL the derecognition gains or losses are recognised together with the measurement result in the lines 'Net trading result' or 'Gains/losses from financial instruments measured at fair value through profit or loss'.

In the comparative period line items 'Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net', 'Result from financial assets and liabilities designated at fair value through profit or loss' and 'Net trading result' are used depending on the measurement category of the derecognised financial assets.

ii. Derecognition criteria with respect to contractual modifications of financial assets

In the normal course of running its lending business and in agreement with the respective debtors, the Group may renegotiate or otherwise modify some terms or conditions of the underlying contracts. This can involve either market-driven commercial renegotiations or contractual changes aimed at alleviating or preventing borrower's financial difficulty. For the purpose of capturing the economic substance and financial effect of such contractual modifications, the Group has developed a set of criteria to assess whether or not the modified terms are substantially different from the original terms. While having been partly applied in the IAS 39 environment, these criteria have been further adapted to concepts brought by IFRS 9, e.g. modification of contractual cash flows.

Some derecognition criteria distinguish whether contractual modifications are applied to debtors facing financial difficulties. Application of certain modifications to debtors in financial difficulties is not considered as substantial since they are aimed at improving the prospects of the bank to recover the claims by tailoring the repayment schedules to specific financial conditions of those debtors. On the other hand, such contractual modifications applied to performing debtors may be considered as substantial enough to warrant the derecognition, as further detailed below.

From this perspective the following criteria lead to derecognition unless they are considered as forbearance measures, they are applied to customers in default or they trigger default:

- repayment schedule changed in a way that the weighted remaining maturity of the assets is modified by more than 100% and not less than 2 years compared to the original asset;
- change in timing/amount of contractual cash flows resulting in the present value of the modified cash flows (discounted at pre-modification effective interest rate) being different by more than 10% of the gross carrying amount of the asset immediately before the modification (cumulative assessment considering all modifications occurring over the last twelve months); or
- commercial renegotiations initiated by a debtor seeking better terms as an alternative to re-financing while a prepayment / early termination option and a sufficiently competitive refinancing market exist. Furthermore, the costs that the debtor would incur in case of prepayment / early termination would have to be assessed as sufficiently low for not deterring it. This derecognition trigger rarely applies to loan assets in Stage 2 and never in Stage 3.

If contractual modifications which qualify as forbearance measures are applied to customers in default or trigger default are so significant that they are qualitatively assessed as an extinguishment of original contractual rights, they result in derecognition. Examples of such modifications are:

- a new agreement with materially different terms signed-up as part of distressed restructuring following a standstill agreement suspending the rights of the original assets;
- consolidation of multiple original loans into one with substantially different terms; or
- transformation of a revolving loan into non-revolving.

Contractual modifications leading to derecognition of the related original assets result in the initial recognition of new financial assets. If the debtor is in default or the significant modification leads to the default, then the new asset will be treated as POCI. The difference between the carrying amount of the derecognised asset and initial fair value of the new POCI asset is presented in the statement of income in the line 'Impairment result from financial instruments'.

If the debtor is not in default or the significant modification does not lead to default, the new asset recognised after derecognition of the original asset will be in Stage 1. For loans measured at amortised cost the unamortized balance of the origination fees/transaction costs considered in the effective interest rate is presented in the line 'Net interest income' at the derecognition date. The release of the credit loss allowance attached to the original asset at the date of that significant modification, as well as the credit loss allowance recognised for the new asset are presented in the line 'Impairment

result from financial instruments'. The remaining difference is presented in the line 'Gains/losses from derecognition of financial assets measured at amortised cost'.

For financial assets measured at FVPL, irrespective of whether they are in default, the derecognition gains and losses are included in the same line items of the statement of income as their measurement result, i.e. in 'Gains/losses from financial instruments measured at fair value through profit or loss'.

For debt instrument assets not measured at FVPL that are subject to contractual modifications that do not result in derecognition, the gross carrying amount of the asset is adjusted against recognising a modification gain or loss in profit or loss. The modification gain or loss equals the difference between the gross carrying amount before the modification and the present value of the cash flows based on the modified terms discounted with the original effective interest rate. In the statement of income the modification gain or loss is presented in the line 'Net interest income' (sub-items "Interest income" or "Interest expenses").

iii. Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. This normally occurs when the liability is repaid or repurchased. In the statement of income the difference between the carrying amount of the derecognised financial liability and the consideration paid is presented in the line 'Other gains/losses from financial instruments not measured at fair value through profit or loss' (in the comparative period 'Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net'), 'Gains/losses from financial instruments measured at fair value through profit or loss' and 'Net trading result' depending on the measurement category of the derecognised financial liability.

Derivative financial instruments

Derivatives used by the Group include mainly interest rate swaps, futures, forward rate agreements, interest rate options, currency swaps and currency options. Derivatives are measured at fair value. Derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

For presentation purposes derivatives are split into:
- Derivatives – held for trading; and
- Derivatives – hedge accounting.

Derivatives – held for trading are those which are not designated as hedging instruments. They are presented in the line item 'Derivatives' under the heading 'Financial assets / financial liabilities – held for trading'. All kinds of non-hedging derivatives without regard to their internal classification, i.e. both derivatives held in the trading book and banking book are presented in this line item.

Derivatives – hedge accounting are those which are designated as hedging instruments in hedges fulfilling the conditions of IAS39. In the statement of financial position, they are presented in the line item 'Derivatives - hedge accounting' on asset or liability side.

Changes in fair value (clean price) of derivatives in fair value hedges are recognised in the income statement in the line item 'Net trading result'. The effective part of changes in fair value (clean price) of derivatives in cash flow hedges is reported in other comprehensive income in the line item 'Cash flow hedge reserve'. Ineffective part of changes in fair value (clean price) of derivatives in cash flow hedges is recognised in profit or loss under the line item 'Net trading result'.

Interest income/expense related to derivatives in fair value hedges is recognised in the income statement in the line item 'Net interest income' (sub-items "Other similar income" or "Other similar expenses"). Interest income/expense from hedging derivatives in cash flow hedges is part of the dirty price measurement which is split into effective part and ineffective part as described above.

Embedded derivatives in the comparative period and based on IFRS 9

The Group is involved in business with debt instruments containing structured features. Structured features mean that a derivative is embedded in the host instruments. Embedded derivatives are separated from the host debt instruments if
- The economic characteristics of the derivatives are not closely related to the economic characteristics and risks of the host debt instruments;
- The embedded derivative meets the IAS 39 definition of derivative; and
- The hybrid instrument is not a financial asset or liability held for trading or designated at fair value through profit or loss.

Embedded derivatives that are separated are accounted for as stand-alone derivatives and presented in the statement of financial position under the line item 'Derivatives' in financial assets – held for trading or financial liabilities – held for trading.

At the Group, derivatives that are not closely related and are separated are predominantly embedded in issued host debt instruments recognised as liabilities. The most typical cases are issues of bonds and deposits that contain interest caps, floors or collars that were in the money at origination, contractual features linking payments to non-interest variables such as FX rates, equity and commodity prices and indices, or third-party credit risk.

From 2018 based on IFRS 9, instead of separating the embedded derivatives, the Group designates the entire financial liability as measured at FVPL.

Repurchase and reverse repurchase agreements

Transactions where securities are sold under an agreement to repurchase at a specified future date are also known as 'repos' or 'sale and repurchase agreements'. Securities sold are not derecognised from the statement of financial position, as the Group retains substantially all the risks and rewards of ownership because the securities are repurchased at a fixed price when the repo transaction ends. Furthermore, the Group is the beneficiary of all the coupons and other income payments received on the transferred assets over the period of the repo transactions. These payments are remitted to the Group or are reflected in the repurchase price.

The corresponding cash received is recognised in the statement of financial position with a corresponding obligation to return it as a liability under the line item 'Financial liabilities measured at amortised cost', sub-items 'Deposits from banks' or 'Deposits from customers' reflecting the transaction's economic substance as a loan to the Group. The difference between the sale and repurchase prices is treated as interest expense and recorded in the income statement under the line item 'Net interest income' (sub-item "Interest expenses") and is accrued over the life of the agreement. Financial assets transferred out by the Group under repurchase agreements remain on the Group's statement of financial position and are measured according to the rules applicable to the respective statement of financial position item. Moreover, they are presented in "Thereof pledged as collateral" positions under the respective balance sheet items.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. Such transactions are also known as 'reverse repos'. The consideration paid is recorded in the statement of financial position under the respective line items 'Loans and receivables to credit institutions' or 'Loans and receivables to customers', reflecting the transaction's economic substance as a loan by the Group. The difference between the purchase and resale prices is treated as interest income and is accrued over the life of the agreement and recorded in the income statement under the line item 'Net interest income' (sub-item "Interest income").

Securities lending and borrowing

In securities lending transactions, the lender transfers ownership of securities to the borrower on the condition that the borrower will retransfer, at the end of the agreed loan term, ownership of instruments of the same type, quality and quantity and will pay a fee determined by the duration of the lending. The transfer of the securities to counterparties via securities lending does not result in derecognition. Substantially all the risks and rewards of ownership are retained by the Group as a lender because the securities are received at the end of the securities lending transaction. Furthermore, the Group is the beneficiary of all the coupons and other income payments received on the transferred assets over the period of the securities lendings.

The securities lent are presented in "thereof pledged as collateral" positions under the respective balance sheet items.

Securities borrowed are not recognised in the statement of financial position unless they are then sold to third parties. In this case, the obligation to return the securities is recorded as a short sale within 'Other trading liability'.

Hedge accounting

The Group makes use of derivative instruments to manage exposures to interest rate risk and foreign currency risk. At inception of a hedge relationship, the Group formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated are expected to offset the fair value changes of the hedging instrument in a range of 80% to 125%. Hedge effectiveness is assessed at inception and throughout the term of each hedging relationship. Exact conditions for particular types of hedges and for testing the hedge effectiveness by the Group are specified internally in hedge policy.

(i) Fair value hedges

Fair value hedges are employed to reduce market risk. For qualifying and designated fair value hedges, the change in the fair value (clean price) of a hedging instrument is recognised in the income statement under the line item 'Net trading result'. Interest income and expenses on hedging derivatives are reported under the line item 'Net interest income' (sub-items "Other similar income or "Other similar expenses"). The change in the fair value of the hedged item attributable to the hedged risk is also recognised in the income statement under the line item 'Net trading result' and adjusts the carrying amount of the hedged item.

If the hedging instrument expires, is sold, is terminated or is exercised, or when the hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. In this case, the fair value adjustment of the hedged item is amortised to the income statement under the line item 'Net interest income' (sub-items "Other similar income or "Other similar expenses") until maturity of the financial instrument.

(ii) Cash flow hedges

Cash flow hedges are used to eliminate uncertainty in the future cash flows in order to stabilise net interest income. For designated and qualifying cash flow hedges, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and reported under the 'Cash flow hedge reserve'. The ineffective portion of the gain or loss on the hedging instrument is recognised in the income statement under the line item 'Net trading result'. For determination of the effective and ineffective portions, the derivative is considered at its dirty price, i.e. including the interest

component. If the hedged cash flow affects the income statement, the gain or loss on the hedging instrument is reclassified from other comprehensive income in the corresponding income or expense line item in the income statement (mainly 'Net interest income'; sub-items "Other similar income or "Other similar expenses"). As far as accounting for hedged items in cash flow hedges is concerned there is no change compared to the situation when no hedging is applied.

When a hedging instrument expires, is sold, is terminated, is exercised, or when a hedge no longer meets the criteria for hedge accounting, the hedge relationship is terminated. In this case, the cumulative gain or loss on the hedging instrument that has been recognised in other comprehensive income remains separate in 'Cash flow hedge reserve' until the transaction occurs.

Offsetting financial instruments

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

Financial guarantees in the comparative period

In the ordinary course of business, the Group provides financial guarantees, consisting of various types of letters of credit and guarantees. According to IAS 39, a financial guarantee is a contract that requires the guarantor to make specified payments to reimburse the holder for a loss it incurs in case a specified debtor fails to make a payment when due in accordance with the original or modified terms of a debt instrument.

If the Group is in a position of being a guarantee holder, the financial guarantee is not recorded in the statement of financial position but is taken into consideration as collateral when determining impairment of the guaranteed asset.

The Group as a guarantor recognises financial guarantees as soon as it becomes a contracting party (i.e. when the guarantee offer is accepted). Financial guarantees are initially measured at fair value. Generally, the initial measurement is the premium received for a guarantee. If no premium is received at contract inception, the fair value of a financial guarantee is nil, as this is the price that would be paid to transfer the liability in an orderly transaction between market participants. Subsequent to initial recognition, the financial guarantee contract is reviewed for the possibility that provisioning will be required under IAS 37. Such provisions are presented in the statement of financial position under the line 'Provisions'.

The premium received is recognised in the income statement under the line item 'Net fee and commission income' on a straight-line basis over the life of the guarantee.

Leasing

A lease is an agreement whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments. A finance lease at the Group is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. All other lease agreements at the Group are classified as operating leases.

The Group as a lessor

The lessor in the case of a finance lease reports a receivable from the lessee under the line item 'Loans and receivables to customers' or 'Loans and receivables to credit institutions'. The receivable is equal to the present value of the contractually agreed payments taking into account any residual value. Interest income on the receivable is reported in the income statement under the line item 'Net interest income' (sub-item "Interest income").

In the case of operating leases, the leased asset is reported by the lessor in 'Property and equipment' or in 'Investment properties' and is depreciated in accordance with the principles applicable to the assets involved. Lease income is recognised on a straight-line basis over the lease term in the income statement under the line item 'Rental income from investment properties & other operating leases'.

Lease agreements in which the Group is the lessor almost exclusively comprise finance leases.

The Group as a lessee

As a lessee, the Group has not entered into any leases meeting the conditions of finance leases. Operating lease payments are recognised as an expense in the income statement on the line item 'Other administrative expenses' on a straight-line basis over the lease term.

Foreign currency translation

The consolidated financial statements are presented in Czech crowns. The functional currency is the currency of the primary business environment in which an entity operates. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency.

For foreign currency translation, spot exchange rates quoted by the Czech National Bank are used. For Group entities using the Euro as functional currency, these are the European Central Bank ('ECB') reference rates.

(i) Transactions and balances in foreign currency

Transactions in foreign currencies are initially recorded at the functional currency exchange rate effective as of the date of the transaction. Subsequently, monetary assets and liabilities denominated in foreign currencies are translated at the functional currency exchange rate as of the balance sheet date. All resulting exchange differences that arise are recognised in the income statement under the line

item 'Net trading result'. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as of the dates of the initial transactions. Non–monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(ii) Translation of the statements of Group companies

Assets and liabilities of foreign operations (foreign subsidiaries and branches) are translated into Group's presentation currency, the Czech crown, at the rate of exchange as of the balance sheet date (closing rate). Their consolidated statements of income and consolidated statements of comprehensive income are translated at average exchange rates calculated on the basis of daily rates. Goodwill, intangible assets recognised on acquisition of foreign subsidiaries (i.e. customer relationships and brand) and fair value adjustments to the carrying amounts of assets and liabilities on the acquisition are treated as assets and liabilities of the foreign subsidiaries and are translated at the closing rate. Exchange differences arising on translation are recognised in other comprehensive income. On disposal of a foreign subsidiary, the cumulative amount of translation differences recognised in other comprehensive income is recognised in the income statement under the line item 'Other operating result'.

Business combinations and goodwill

(i) Business combinations

Business combinations are accounted for using the acquisition method of accounting. Goodwill represents the future economic benefits resulting from the business combination, arising from assets that are not individually identified and separately recognised. Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests and the fair value of the previously held equity interest over the net of the acquisition-date amounts of the identifiable assets acquired as well as the liabilities assumed. At the acquisition date, the identifiable assets acquired and the liabilities assumed are generally recognised at their fair values.

If, after reassessment of all components described above, the calculation results in a negative amount, it is recognised as a bargain purchase gain and reported in the income statement under the line item 'Other operating result' in the year of acquisition.

Non-controlling interests that are present ownership interests in the acquiree are measured at the proportionate share of the acquiree's identifiable net assets. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS. Acquisition costs incurred are expensed and included under the income statement line item 'Other operating result'.

(ii) Goodwill and goodwill impairment testing

Goodwill arising on acquisition of a business is carried at cost as established as of the date of acquisition of the business less accumulated impairment losses, if any. Goodwill is tested for impairment annually in the fourth quarter, or whenever there is an indication of possible impairment during the year, with any impairment determined recognised in profit or loss. The impairment test is carried out for each cash-generating unit (CGU) to which goodwill has been allocated. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Goodwill is tested for impairment by comparing the recoverable amount of each CGU to which goodwill has been allocated with its carrying amount. The carrying amount of a CGU is based on the amount of net asset value allocated to the CGU taking into account any goodwill and unamortised intangible assets recognised for the CGU at the time of business combination.

The recoverable amount is the higher of a CGU's fair value less costs of disposal and its value in use. Where available, the fair value less costs of disposal is determined based on recent transactions, market quotations or appraisals. The value in use is determined using a discounted cash flow model (DCF model), which incorporates the specifics of the banking business and its regulatory environment. In determining value in use, the present value of future earnings distributable to shareholders is calculated.

The estimation of future earnings distributable to shareholders is based on financial plans for the CGUs as agreed by the management while taking into account the fulfilment of the respective regulatory capital requirements. The planning period is five years. Any forecasted earnings beyond the planning period are derived on the basis of the last year of the planning period and a long-term growth rate. The present value of such perpetual earnings growing at a stable rate (referred to as terminal value) takes into consideration macroeconomic parameters and economically sustainable cash flows for each CGU.

The cash flows are determined by subtracting the annual capital requirement generated by a change in the amount of risk-weighted assets from the net profit. The capital requirement was defined through the target tier 1 ratio in light of the expected future minimum regulatory capital requirements.

The value in use is determined by discounting the cash flows at a rate that takes into account present market rates and the specific risks of the CGU. The discount rates have been determined based on the capital asset pricing model (CAPM). According to the CAPM, the discount rate comprises a risk-free interest rate together with a market risk premium that itself is multiplied by a factor that represents the systematic market risk (beta factor). Furthermore, a country-risk premium component is considered in calculation of the discount rate. The values used to establish the discount rates are determined using external sources of information.

Where the recoverable amount of a CGU is less than its carrying amount, the difference is recognised as an impairment loss in the income statement under the line item 'Other operating result'. The impairment loss is allocated first to write down the CGU's goodwill.

Any remaining impairment loss reduces the carrying amount of the CGU's other assets, though not to an amount lower than their fair value less costs of disposal. No impairment loss is recognised if the recoverable amount of the CGU is higher than or equal to its carrying amount. Impairment losses relating to goodwill cannot be reversed in future periods.

Property and equipment

Property and equipment is measured at cost less accumulated depreciation and accumulated impairment. Borrowing costs for qualifying assets are capitalised into the costs of property and equipment.

Depreciation is calculated using the straight-line method to write down the cost of property and equipment to their residual values over their estimated useful lives. Depreciation is recognised in the income statement on the line item 'Depreciation and amortisation' and impairment under the line item 'Other operating result'.

The estimated useful lives are as follows:

	Useful life in years
Buildings	15–50
Office furniture and equipment	4–10
Passenger cars	4–8
Computer hardware	**4–6**

Land is not depreciated.

Property and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on disposal of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the income statement under the line item 'Other operating result'.

Investment properties

Investment property is property (land and buildings or part of a building or both) held for the purpose of earning rental income or for capital appreciation. In the case of partial own use, the property is investment property only if the owner-occupied portion is insignificant. Investments in land and buildings under construction, where the future use is expected to be the same as for investment property, are treated as investment property.

Investment property is measured initially at cost, including transaction costs. Subsequent to initial recognition, investment property is measured at cost less accumulated depreciation and impairment. Investment property is presented in the statement of financial position in the line item 'Investment properties'.

Rental income is recognised in the line 'Rental income from investment properties and other operating leases'. Depreciation is presented in the income statement in the line item 'Depreciation and amortisation' using the straight-line method over an estimated useful life. The useful lives of investment properties are identical to those of buildings reported under property and equipment. Any impairment losses, as well as their reversals, are recognised under the income statement line item 'Other operating result'.

Intangible assets

In addition to goodwill, the Group's intangible assets include computer software and customer relationships, the brand, the distribution network and other intangible assets. An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Group.

Costs of internally generated software are capitalised if the Group can demonstrate the technical feasibility and intention of completing the software, the ability to use it, how it will generate probable economic benefits, the availability of resources and the ability to measure the expenditures reliably. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The cost of intangible assets acquired in a business combination is their fair value as of the date of acquisition. In the case of the Group, these are brands, customer relationships and distribution networks, and they are capitalised on acquisition if they can be measured with sufficient reliability.

Intangible assets with finite lives are amortised over their useful economic lives using the straight-line method. The amortisation period and method are reviewed at least at each financial year-end and adjusted if necessary. The amortisation expense on intangible assets with finite lives is recognised in the income statement under the line item 'Depreciation and amortisation'.

The estimated useful lives are as follows:

	Useful life in years
Computer software	4–8
Customer relationships	10–20
Distribution network	5.5

Brands are not amortised as they are assumed to have an indefinite useful life. An intangible asset has an indefinite useful life, if there are no legal, contractual, regulatory or other factors limiting that useful life. Brands are tested for impairment annually within the cash-generating unit to which they belong, and impairment is recognised if appropriate. Furthermore, each period brands are reviewed as to whether current circumstances continue to support the conclusion as to indefinite life. In the event of impairment, impairment losses are recognised in the income statement under the line item 'Other operating result'.

Impairment of non-financial assets (property and equipment, investment properties, intangible assets)

The Group assesses at each reporting date whether there is an indication that a non-financial asset may be impaired. Testing for impairment is done at individual asset level if the asset generates cash inflows that are largely independent of those from other assets. The typical case is investment property. Otherwise the impairment test is carried out at the level of the cash-generating unit (CGU) to which the asset belongs. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For specific rules related to impairment of goodwill and impairment allocation rules for CGUs please see the chapter 'Business combinations and goodwill', part (ii) Goodwill and goodwill impairment testing.

If any indication of impairment exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of the asset's or CGU's fair value less costs of disposal and its value in use. If the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In measuring value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

At each reporting date an assessment is made as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such an indication exists, the Group estimates the asset's or CGU's recoverable amount. The previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount or does not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years.

Impairments and their reversals are recognised in the income statement under the line item 'Other operating result'.

Non-current assets and disposal groups held for sale

Non-current assets are classified as held for sale if they can be sold in their present condition and the sale is highly probable within 12 months of classification as held for sale. If assets are to be sold as part of a group that may also contain liabilities (e.g. a subsidiary) they are referred to as disposal group held for sale.

Assets classified as held for sale and assets belonging to disposal groups held for sale are reported under the statement of financial position line item 'Assets held for sale'. Liabilities belonging to the disposal groups held for sale are presented in the statement of financial position under the line item 'Liabilities associated with assets held for sale'.

Non-current assets and disposal groups that are classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Should the impairment loss in a disposal group exceed the carrying amount of the assets that are within the scope of IFRS 5 measurement requirements, there is no specific guidance on how to treat such a difference. The Group recognises this difference as a provision under the statement of financial position line item 'Provisions'.

Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. In the statement of financial position, provisions are reported under the line item 'Provisions'. They include credit risk loss provisions for contingent liabilities (particularly financial guarantees and loan commitments) as well as provisions for litigation and restructuring. Expenses or income related to provisions are reported under the line item 'Other operating result'. However restructuring expenses are presented under line item Personnel expenses.

A provision for restructuring is recognized when the Group has approved a detailed and formal restructuring plan and the restructuring has either commenced or has been announced publicly before the end of the reporting period. Any restructuring provision only includes the direct expenditure arising from the restructuring which is necessarily entailed and is not associated with the ongoing activities of the Group.

Taxes

(i) Current tax

Current tax assets and liabilities for the current and prior years are measured as the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amounts are those enacted by the balance sheet date.

(ii) Deferred tax

Deferred tax is recognised for temporary differences between the tax bases of assets and liabilities and their carrying amounts as of the balance sheet date. Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carry forward of unused tax losses can be utilised. Deferred taxes are not recognised on temporary differences arising from the initial recognition of goodwill.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or

part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the temporary difference is reversed or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted as at balance sheet date and are expected to apply when the temporary differences are reversed.

Deferred tax relating to items recognised in other comprehensive income is recognised in other comprehensive income and not in the income statement.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right to offset exists and the deferred taxes relate to the same taxation authority.

Share capital

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

Fiduciary assets

The Group provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its clients. Assets held in a fiduciary capacity are not reported in the financial statements, as they are not the assets of the Group.

Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Group's shareholders.

Items of the statement of income

The description and recognition criteria of the line items reported in the statement of income are as follows:

i. Net interest income

Interest income and interest expense are recorded using the EIR method as discussed in chapter 'Financial instruments', 'Measurement methods for financial instruments', part (i) Amortised cost and effective interest rate.

Net interest income and its sub-item "Interest income" includes interest income on loans and advances to credit institutions and customers, on cash balances, and on bonds and other interest-bearing securities in measurement categories of financial assets at amortised cost and financial assets at fair value through other comprehensive income.

Net interest income its sub-item "Interest expenses" includes Interest expenses from deposits from customers, deposits from banks, debt securities issued and other financial liabilities in measurement category of financial liabilities at amortised costs.

Net interest income and its sub-item "Other similar expenses" includes interest expenses from derivative financial instruments (including hedge derivatives) and interest expenses from financial liabilities not classified at amortised costs (i.e. financial liabilities held for trading and financial liabilities at fair value through profit or loss) including negative interest from financial assets.

Net interest income and its sub-item "Other similar income" includes interest income from derivative financial instruments (including hedge derivatives) and interest income from financial assets not classified at amortised costs (i.e. financial assets held for trading and financial assets at fair value through profit or loss) including negative interest from financial liabilities.

In addition, modification gains and losses recognised on financial assets in Stage 1 are presented as net interest income. Further, the unamortised balance of the origination fees/transaction costs upon derecognition of assets in Stage 1 and 2 considered in the effective interest rate is presented in the line 'Net interest income' at the derecognition date.

ii. Net fee and commission income

The Group earns fee and commission income from a diverse range of services that it provides to its customers.

Fees earned for the provision of services over a period of time are accrued over that period. These fees include fees from other lending activities, guarantee fees, commission income from asset management, custody and other management and advisory fees as well as fees from insurance brokerage, building society brokerage, foreign exchange transactions and payment services.

Fee income earned from providing transaction services, such as arranging the acquisition of shares or other securities or the purchase or sale of businesses, is recognised upon completion of the underlying transaction.

iii. Dividend income

Dividend income is recognised when the right to receive the payment is established. This line item includes dividends from all shares and other equity investments, i.e. from those that are held for trading, non-trading equity instruments at FVPL and at FVOCI.

iv. Net trading result

Results arising from trading activities include all gains and losses from changes in the fair value (clean price) of financial assets and financial liabilities classified as held for trading, including all derivatives not designated as hedging instruments. The net trading result also includes any ineffective portions recorded in fair value

and cash flow hedge transactions as well as foreign exchange gains and losses on all monetary assets and liabilities.

v. Gains/losses from financial instruments measured at fair value through profit or loss

Under this line item changes in fair value (clean price) of non-trading financial assets at fair value through profit or loss, including gains and losses on their derecognition, are presented. This concerns both non-trading financial assets designated and those mandatorily measured at FVPL. Further, gains and losses (clean price) of financial liabilities designated at FVPL, including gains and losses on their derecognition, are presented under this line item. In the comparative period this line item includes only changes in fair value (clean price) of financial assets and liabilities designated at FVPL.

vi. Net result from equity method investments

The line item contains result from associates recorded by applying the equity method (measured as the investor's share of profit or loss in the associates).

However, impairment losses, reversal of impairment losses and realised gains and losses on investments in associates accounted for using the equity method are reported under the line item 'Other operating result'.

vii. Rental income from investment properties & other operating leases

Rental income from investment properties and other operating leases (i.e. mainly from real-estate and cars) is recognised on a straight-line basis over the lease term.

viii. Personnel expenses

Personnel expenses include wages and salaries, bonuses, statutory and voluntary social security contributions, staff-related taxes and levies. They also include service cost for severance payment. Furthermore, restructuring provisions expenses may be part of personnel expenses.

ix. Other administrative expenses

Other administrative expenses include information technology expenses, expenses for office space, office operating expenses, advertising and marketing, expenditures for legal and other consultants as well as sundry other administrative expenses. Furthermore the line item contains deposit insurance contributions expenses.

x. Depreciation and amortisation

This line item comprises depreciation of property and equipment, depreciation of investment property and amortisation of intangible assets.

xi. Gains/losses from derecognition of financial assets measured at amortised cost

This line item includes selling and other derecognition gains or losses on financial assets measured at amortised cost.

xii. Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss

This line item includes selling and other derecognition gains or losses on financial assets at FVOCI, financial liabilities measured at amortised cost and other financial instruments not measured at FVPL, such as finance lease receivables or financial guarantees.

xiii. Impairment result from financial instruments

Net impairment losses on financial instruments comprise impairment losses and reversals of impairment on all kinds of financial instruments, to which the IFRS 9 expected credit loss impairment model applies. The impairment result also includes recoveries on written-off financial assets.

xiv. Other operating result

Other operating result reflects all other income and expenses not directly attributable to the Group's ordinary activities. Other operating result includes impairment losses or any reversal of impairment losses as well as results on the sale of property and equipment and intangible assets. Also included here are any impairment losses on goodwill.

In addition, other operating result encompasses the following: expenses for other taxes; income from the release of and expenses for allocations to provisions; impairment losses (and their reversal if any) as well as selling gains and losses on equity investments accounted for using the equity method; and gains or losses from derecognition of subsidiaries. Furthermore the line item contains contributions to Resolution Fund.

There are two additional line items in the statement of income which are relevant only for the comparative period:

xv. Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net in the comparative period

This line item includes selling and other derecognition gains or losses on available-for-sale and held-to-maturity financial assets, loans and receivables and financial liabilities measured at amortised cost. However, if such gains/losses relate to individually impaired financial assets they are included as part of the net impairment loss.

xvi. Net impairment loss on financial assets in the comparative period

Net impairment losses on financial assets comprise impairment losses and reversals of impairment on loans and receivables, held-to-maturity and available-for-sale financial assets. Net impairment losses relate to allowances recognised both at individual and portfolio (incurred but not reported) level. Direct write-offs are considered as part of impairment losses. This line item also includes recoveries on written-off loans removed from the balance sheet.

Significant Accounting Judgements, Assumptions and Estimates

The consolidated financial statements contain amounts that have been determined on the basis of judgements and by the use of estimates and assumptions. The estimates and assumptions used are based on historical experience and other factors, such as planning as well as expectations and forecasts of future events that are currently deemed to be reasonable. As a consequence of the uncertainty associated with these assumptions and estimates, actual results could in future periods lead to adjustments in the carrying amounts of the related assets or liabilities. The most significant uses of judgements, assumptions and estimates are as follows:

SPPI assessment

The assessment of whether the contractual cash flows of financial assets give rise to cash flows that are solely payments of principal and interest (SPPI) is subject to the application of significant judgements. These judgements are crucial in the IFRS 9 classification and measurement process as they determine whether the asset has to be measured at FVPL or, depending on the business model assessment, at amortised cost or at FVOCI. When taking into consideration specific features of loans in the business of the Group, significant areas of judgement are prepayment fees, project financing loans and benchmark test for loans with interest mismatches features.

The assessment whether the prepayment fees applied to loans can be considered as a reasonable compensation for early terminations or prepayments is based on comparing the level of the fees with the economic costs incurred by the bank upon the early termination. For these purposes, the Group uses a quantitative test where the costs relate to the lost interest margin and the lost interest differential due to a decrease in the interest rates upon early termination or prepayment. The evaluation is normally performed on a portfolio level. The adequacy of the fees can also be defended on a qualitative basis such as common market practice regarding level prepayment fees and their acceptance by authorities.

For project financing loans the Group assesses whether they represent basic loan agreements rather than investments in the financed projects. In this respect credit rating, level of collateralisation, existing sponsor guarantees and the extent of equity funding of the financed projects are considered.

The most critical area of SPPI judgements in the business of the Group comprises loans with interest mismatch features. Interest mismatches relate to floating rate financial assets (loans and some debt securities, also referred to as 'deals') where:

- the reference rate's (such as Pribor) tenor is different to the rate reset frequency (such as 3-year rate reset every year or interest rate "basket" consisting of short and long-term interest rates reset every 3 month, also referred to as 'tenor mismatch'),
- the interest rate is fixed prior to the start of the interest period (such as 3-month Pribor fixed 2 months before the interest period starts), or
- time lags arise from average rates over previous periods or
- combinations of these features.

For this purpose, the Group has developed a so called 'benchmark test' to assess whether the interest mismatch feature could result in contractual (undiscounted) cash flows that are significantly different from benchmark assets. The benchmark deal does not have the interest mismatch feature (i.e. if the floating rate reset frequency is 3 months then the floating rate would be the 3-month Euribor and/or no time lag exists in the floating rate fixation), but otherwise its terms correspond to the asset in the test.

For assets with interest mismatches resulting only from prior and average rates (i.e. no mismatches resulting from a tenor different from the reset frequency) the SPPI compliance is considered to be met based on a qualitative assessment if the time lag between the fixation of the rate and the start of the interest period does not exceed one month. This is supported by a quantitative analysis performed by the bank for this purpose.

The quantitative benchmark test is performed (in case of the interest mismatch feature on tested deal) at the deal´s initial recognition and uses forward-looking simulations of future market interest rates over the life of the deal.

Business model assessment

For each SPPI-compliant financial asset at initial recognition, the Group has to assess whether it is part of a business model where the assets are held in order to collect contractual cash flows, to both collect the contractual cash flows and sell the assets, or they are held in other business models. As a consequence, the critical aspect in distinguishing the business models is frequency and significance of sales of assets in the respective business model. Since the asset allocation to business models is based on the initial assessment, it may happen that in subsequent periods cash flows are realised differently than originally expected and a different measurement method may seem to be appropriate. In accordance with IFRS 9 such subsequent changes do not generally lead to reclassifications or prior period error corrections in respect of existing financial assets. The new information on how cash flows are realised may, however, indicate that the business model and thus the measurement method changes for newly acquired or newly originated financial assets.

At the Group, sales due to increases in credit risk, sales close to assets' maturity, infrequent sales triggered by a non-recurring event (such as changes in regulatory or tax environment, major internal reorganisation or a business combination, severe liquidity crisis, etc.) are considered as not contradicting the held to collect contractual cash flows business model. Other kinds of sales carried out in the 'held to collect' business model are assessed retrospectively and if they exceed certain quantitative thresholds, or whenever it is considered necessary with regard to new expectations, the Group performs a prospective test. If the outcome was that the carrying amount of assets expected to be sold over the expected life of the current business model portfolio, for reasons other than the cases above, exceeds 10% of the carrying amount of the portfolio, any new acquisitions or originations of assets in the portfolio would be classified in a different business model.

Impairment of financial instruments

The expected credit loss impairment model is inherently based on judgement since it requires assessment of significant increases in credit risk and measurement of expected credit losses without providing detailed guidance. In respect of significant increases in credit risk, the Group has determined specific assessment rules consisting of qualitative information and quantitative thresholds. Another area of complexity relates to establishing groups of similar assets when credit risk deterioration has to be assessed on a collective basis before specific information is available at individual instrument level.

Measurement of expected credit losses involves complex models relying on historical statistic of probabilities of default and loss rates in case of defaults, their extrapolations in case of insufficient observations, individual estimates of credit-adjusted cash flows and probabilities of different scenarios including forward-looking information. In addition, the life of the instruments has to be modelled in respect of prepayment possibilities and in respect of behavioural life of revolving credit facilities.

Under the IAS 39 incurred loss impairment model used for the comparative period, the Group reviewed its financial assets not measured at fair value through profit or loss at each balance sheet date to assess whether an impairment loss should be recorded in the statement of income. In particular, this involved determining whether there is objective evidence of impairment as a result of a loss event occurring after initial recognition and estimating the amount and timing of future cash flows when determining an impairment loss.

Detailed disclosures about identification of significant increases in credit risk including collective assessment, estimation techniques used to measure 12-month and lifetime expected credit losses and definition of default is provided in Note 36 Risk management, part Credit risk. The development of loan loss provisions is described in Note 21 Financial assets at fair value through other comprehensive income, Note 25 Financial assets at amortised cost and Note 26 Finance lease receivables. The development of loan loss provisions in the comparative period is included in Note 23 Loans and receivables to credit institutions and Note 24 Loans and receivables to customers.

The Notes to the Statement of Comprehensive Income and the Statement of Financial Position of Česká spořitelna, a.s.

1. Net interest income

in CZK million	1–6 2018	1–6 2017
Interest and other similar income		
Available-for-sale financial assets	–	349
Financial assets at fair value through other comprehensive income	311	–
Financial assets at amortised costs	14,008	–
Loans and receivables	–	10,386
Held-to-maturity investments	–	2,102
Interest income	**14,319**	**12,837**
Financial assets held for trading	1,529	675
Financial assets at fair value through profit or loss	–	8
Non-trading financial assets at fair value through profit or loss	7	–
Derivatives – Hedge accounting, interest rate risk	119	85
Other assets	36	5
Negative interest from financial liabilities	141	121
Other similar income	**1,832**	**894**
Total interest and other similar income	**16,151**	**13,731**
Interest and other similar expense		
Financial liabilities measured at amortised cost	(1,502)	(870)
Interest expenses	**(1,502)**	**(870)**
Financial liabilities at fair value through profit or loss	(1)	–
Financial liabilities held for trading	(1,456)	(506)
Derivatives – Hedge accounting, interest rate risk	8	2
Other liabilities	(1)	–
Negative Interest from financial assets	(55)	(12)
Other similar expenses	**(1,505)**	**(516)**
Total interest and other similar expense	**(3,007)**	**(1,386)**
Net interest income	**13,144**	**12,345**

2. Net fee and commission income

in CZK million	1–6 2018	1–6 2017
Securities	612	545
Clearing and settlement	69	90
Asset management	497	408
Custody	63	93
Payment services	1,921	2,196
Customer resources distributed but not managed	397	398
Insurance products	306	258
Building society brokerage	91	140
Lending business	674	697
Other	54	46
Net fee and commission income	**4,287**	**4,473**
Fee and commission income	**5,923**	**5,931**
Fee and commission expenses	**(1,636)**	**(1,458)**

3. Dividend income

in CZK million	1–6 2018	1–6 2017
Financial assets – at fair value through profit or loss	–	4
Non-trading financial assets at fair value through profit or loss	44	–
Financial assets – available for sale	–	42
Financial assets at fair value through other comprehensive income	6	–
Dividend income	**50**	**46**

4. Net trading result

in CZK million	1–6 2018	1–6 2017
Securities and derivatives trading	319	557
Foreign exchange transactions	748	1,009
Gains or losses from hedge accounting	(26)	(146)
Net trading result	**1,041**	**1,420**

5. Gains/losses from financial instruments measured at fair value through profit or loss

in CZK million	1–6 2018	1–6 2017
Result from measurement/sale of financial assets designated at fair value through profit or loss	(7)	(9)
Result from measurement/sale of financial liabilities designated at fair value through profit or loss	(12)	(9)
Result from financial assets and liabilities designated at fair value through profit or loss	**(19)**	**(18)**
Result from measurement/repurchase of financial assets mandatorily at fair value through profit or loss	19	-
Gains/losses from financial instruments measured at fair value through profit or loss	**-**	**(18)**

6. Rental income from investment properties & other operating leases

in CZK million	1–6 2018	1–6 2017
Investment properties	83	129
Other operating leases	28	30
Rental income from investment properties & other operating leases	**111**	**159**

7. General administrative expenses

in CZK million	1–6 2018	1–6 2017
Personnel expenses	**(4,694)**	**(4,517)**
Wages and salaries	(3,377)	(3,219)
Compulsory social security	(1,086)	(1,017)
Other personnel expenses	(231)	(281)
Other administrative expenses	**(3,457)**	**(3,473)**
Deposit insurance contribution	(246)	(217)
IT expenses	(1,380)	(1,323)
Expenses for office space	(606)	(640)
Office operating expenses	(350)	(369)
Advertising / marketing	(445)	(393)
Legal and consulting costs	(124)	(143)
Sundry administrative expenses	(306)	(388)
Depreciation and amortization	**(1,009)**	**(1,031)**
Software and other intangible assets	(477)	(489)
Owner occupied real estate	(319)	(318)
Investment property	(31)	(33)
Office furniture and equipment and sundry property and equipment	(182)	(191)
General administrative expenses	**(9,160)**	**(9,021)**

8. Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net

in CZK million	1–6 2018	1–6 2017
From sale of financial assets available for sale	–	210
From sale of financial assets held to maturity	–	65
From sale of loans and receivables	–	(3)
From repurchase of liabilities measured at amortised cost	–	(3)
Gains/losses on financial assets and liabilities not measured at fair value through profit or loss, net	**–**	**269**

9. Gains/losses from derecognition of financial assets measured at amortised cost

in CZK million	1–6 2018	1–6 2017
Gains from sale of financial assets at amortised cost	18	–
Losses from sale of financial assets at amortised cost	(12)	–
Gains/losses from derecognition of financial assets measured at amortised cost	**6**	**–**

10. Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss

in CZK million	1–6 2018	1–6 2017
From sale of financial assets at fair value through other comprehensive income	24	–
Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss	**24**	**–**

11. Net impairment loss on financial assets

in CZK million	1–6 2018	1–6 2017
Financial assets – measured at cost	–	(14)
Financial assets – available for sale	–	1
Loans and receivables	–	280
Allocation to risk provisions	–	(5,015)
Release of risk provisions	–	5,047
Direct write-offs	–	(139)
Recoveries recorded directly to the income statement	–	387
Financial assets – held to maturity	–	(2)
Net impairment loss on financial assets	**–**	**265**

12. Impairment result from financial instruments

in CZK million	1–6 2018	1–6 2017
Financial assets at fair value through other comprehensive income	68	–
Financial assets at amortised cost	875	–
Net allocation to risk provisions	432	–
Direct write-offs	(74)	–
Recoveries recorded directly to the income statement	517	–
Finance lease	(43)	–
Net allocation of provisions for commitments and guarantees given	3	–
Impairment result from financial instruments	**903**	**–**

13. Other operating result

in CZK million	1–6 2018	1–6 2017
Other operating expenses	**(634)**	**(722)**
Allocation to other provision	(8)	–
Other taxes	–	(8)
Recovery and resolution fund contributions	(488)	(427)
Result from other operating expenses/income	(138)	(287)
Other operating income	**75**	**354**
Release of other provision	–	122
Release of provisions for commitments and guarantees given	–	51
Result from properties/movables/other intangible assets other than goodwill	16	181
Other taxes	59	–
Other operating result	**(559)**	**(368)**

14. Taxes on income

Group's consolidated net tax expense for the first six months of 2018 amounted to CZK 1,992 million (Jun 2017: CZK 1,891 million), thereof CZK 3 million net deferred tax income (Jun 2017: income CZK 18 million).

15. Cash and cash balances

in CZK million	Jun 2018	Dec 2017
Cash on hand	25,470	25,104
Cash balances at central banks	112,512	253,017
Other demand deposits	1,828	2,100
Cash and cash balances	**139,810**	**280,221**

A portion of 'Cash balances at central banks' includes mandatory reserve deposits in amount of CZK 13,186 million (2017: CZK 12,389 million). Mandatory reserve deposits accrue interest at the CNB's two week repo rate. The Group is authorised to make withdrawals of minimum reserve deposits in an amount that exceeds the actual average level of minimum reserve deposits for the relevant holding period calculated pursuant to the CNB's regulations.

16. Derivatives – held for trading

in CZK million	Jun 2018			Dec 2017		
	Notional value	Positive fair value	Negative fair value	Notional value	Positive fair value	Negative fair value
Derivatives held in the trading book	**826,385**	**10,511**	**(9,972)**	**648,321**	**10,057**	**(9,506)**
Interest rate	391,084	5,911	(5,629)	307,765	6,571	(6,146)
Foreign Exchange	435,301	4,600	(4,343)	340,556	3,481	(3,359)
Commodity	–	–	–	–	5	(1)
Derivatives held in the banking book	**51,924**	**927**	**(1,800)**	**51,871**	**1,244**	**(1,908)**
Interest rate	11,795	562	(19)	9,429	755	(28)
Foreign exchange	40,129	365	(1,781)	42,442	489	(1,880)
Total	**878,309**	**11,438**	**(11,772)**	**700,192**	**11,301**	**(11,414)**

17. Other trading assets

in CZK million	Jun 2018	Dec 2017
Debt securities	505	132
General governments	264	91
Credit institutions	240	41
Other financial corporations	1	–
Other trading assets	**505**	**132**

18. Financial assets – at fair value through profit and loss

in CZK million	Jun 2018	Dec 2017
Equity instruments	–	53
Debt securities	–	289
General governments	–	–
Credit institutions	–	289
Loans and advances	–	65
Financial assets – at fair value through profit and loss	**–**	**407**

19. Non-trading financial assets at fair value through profit or loss

in CZK million	Jun 2018	
	Designated	Mandatorily
Equity instruments	–	380
Debt securities	281	407
Credit institutions	281	–
Other financial corporations	–	372
Non-financial corporations	–	35
Loans and advances to customers	–	67
Other financial corporations	–	67
Financial assets designated and mandatorily at fair value through profit or loss	281	854
Non-trading financial assets at fair value through profit or loss		**1,135**

Financial assets classified as mandatorily at FVTPL comprise of equities and debt instruments failing SPPI test or which are part of residual business models. Designated financial assets eliminates or significantly reduces an accounting mismatch. More details are described in Classification and subsequent measurement of financial assets under IFRS 9 in section Significant accounting policies.

20. Financial assets – available for sale

in CZK million	Jun 2018	Dec 2017
Equity instruments	–	1,717
Debt securities	–	53,566
General governments	–	36,787
Credit institutions	–	6,902
Other financial corporations	–	2,106
Non-financial corporations	–	7,771
Financial assets – available for sale	–	55,283

21. Financial assets at fair value through other comprehensive income

in CZK million	Gross carrying amount	Credit loss allowances				Accumulated other fair value changes	Net carrying amount
		Stage 1	Stage 2	Stage 3	POCI		
Jun 18							
Equity instruments	1,266	–	–	–	–	–	1,266
Debt securities	50,863	(13)	(24)	–	–	280	51,143
General governments	36,008	(6)	–	–	–	222	36,230
Credit institutions	5,822	–	–	–	–	60	5,882
Other financial corporations	1,307	–	–	–	–	47	1,354
Non-financial corporations	7,726	(7)	(24)	–	–	(49)	7,677
Total	52,129	(13)	(24)	–	–	280	52,409

Allowances for financial assets at fair value through other comprehensive income

In CZK million	As of	Increases due to origination and acquisition	Decreases due to derecognition	Net changes due to change in credit risk	Transfers between Stage 1 and Stages 2/3	Net changes due to modifications without derecognition	Decrease in allowance account due to write-offs	Other adjustments	As of
	1 Jan 18								30 Jun 18
Stage 1	(82)	–	–	64	–	–	–	5	(13)
General governments	(3)	–	–	(3)	–	–	–	–	(6)
Credit institutions	(1)	–	–	1	–	–	–	–	–
Other financial corporations	(55)	–	–	52	–	–	–	3	–
Non-financial corporations	(23)	–	–	14	–	–	–	2	(7)
Stage 2	(22)	–	–	1	–	–	–	(3)	(24)
Non-financial corporations	(22)	–	–	1	–	–	–	(3)	(24)
Total	(104)	–	–	65	–	–	–	2	(37)

22. Financial assets – held to maturity

	Gross carrying amount		Collective allowances		Net carrying amount	
in CZK million	**Jun 2018**	**Dec 2017**	**Jun 2018**	**Dec 2017**	**Jun 2018**	**Dec 2017**
General governments	–	152,206	–	–	–	152,206
Credit institutions	–	11,004	–	(4)	–	11,000
Other financial corporations	–	471	–	(1)	–	470
Non-financial corporations	–	3	–	–	–	3
Financial assets – held to maturity	**–**	**163,684**	**–**	**(5)**	**–**	**163,679**

23. Loans and receivables to credit institutions

Loans and receivables to credit institutions

in CZK million **As of 31 December 2017**	**Gross carrying amount**	**Specific allowances**	**Collective allowances**	**Net carrying amount**
Debt securities	1,892	–	(24)	1,868
Credit institutions	1,892	–	(24)	1,868
Loans and receivables	155,670	–	(13)	155,657
Central banks	135,515	–	–	135,515
Credit institutions	20,155	–	(13)	20,142
Total	**157,562**	**–**	**(37)**	**157,525**

Allowances for loans and receivables to credit institutions

in CZK million	**As of 31 Dec 16**	**Allocations**	**Release**	**Transfer between allowances**	**As of 30 Jun 17**
Specific allowances	**(1)**	**(4)**	**1**	**–**	**(4)**
Loans and receivables	(1)	(4)	1	–	(4)
Credit institutions	(1)	(4)	1	–	(4)
Collective allowances	**(10)**	**(18)**	**18**	**–**	**(10)**
Debt securities	(7)	(7)	7	–	(7)
Credit institutions	(7)	(7)	7	–	(7)
Loans and receivables	(3)	(11)	11	–	(3)
Credit institutions	(3)	(11)	11	–	(3)
Total	**(11)**	**(22)**	**19**	**–**	**(14)**

24. Loans and receivables to customers

Loans and receivables to customers

in CZK million **As of 31 December 2017**	**Gross carrying amount**	**Specific allowances**	**Collective allowances**	**Net carrying amount**
Debt securities with customers	774	–	(4)	770
Non-financial corporations	774	–	(4)	770
Loans and receivables to customers	650,319	(9,730)	(2,665)	637,924
General governments	17,182	–	(11)	17,171
Other financial corporations	18,492	(135)	(51)	18,306
Non-financial corporations	247,570	(5,720)	(1,873)	239,977
Households	367,075	(3,875)	(730)	362,470
Total	**651,093**	**(9,730)**	**(2,669)**	**638,694**

Allowances for loans and receivables to customers

in CZK million	As of 31 Dec 16	Allocations	Use	Release	Interest income from impaired loans	Transfer between allowances	Exchange rate and other changes (+/–)	As of 30 Jun 17	Amounts written off	Recoveries of amounts previously written off
Specific allowances	**(13,015)**	**(3,665)**	**2,979**	**3,767**	**64**	**126**	**43**	**(9,701)**	**139**	**(387)**
Loans and receivables to customers	(13,015)	(3,665)	2,979	3,767	64	126	43	(9,701)	139	(387)
General governments	(1)	(4)	–	1	–	–	–	(4)	–	–
Other financial corporations	(145)	(69)	69	5	–	1	1	(138)	–	–
Non-financial corporations	(6,861)	(1,774)	595	2,250	41	114	42	(5,593)	111	(89)
Households	(6,008)	(1,818)	2,315	1,511	23	11	0	(3,966)	28	(298)
Collective allowances	**(2,524)**	**(1,328)**	**2**	**1,260**	**–**	**(124)**	**8**	**(2,706)**	**–**	**–**
Debt securities with customers	(2)	(4)	2	–	–	–	–	(4)	–	–
Non-financial corporations	(2)	(4)	2	–	–	–	–	(4)	–	–
Loans and receivables to customers	(2,522)	(1,324)	–	1,260	–	(124)	8	(2,702)	–	–
General governments	(11)	(7)	–	6	–	–	–	(12)	–	–
Other financial corporations	(32)	(33)	–	31	–	–	–	(34)	–	–
Non-financial corporations	(1,671)	(834)	–	779	–	(104)	7	(1,823)	–	–
Households	(808)	(450)	–	444	–	(20)	1	(833)	–	–
Total	**(15,539)**	**(4,993)**	**2,981**	**5,027**	**64**	**2**	**51**	**(12,407)**	**139**	**(387)**

25. Financial assets at amortised cost

in CZK million	Gross carrying amount	Credit loss allowances				Net carrying amount
Jun 18		**Stage 1**	**Stage 2**	**Stage 3**	**POCI**	
Debt securities	**186,062**	**(17)**	**–**	**–**	**–**	**186,045**
General governments	174,509	(15)	–	–	–	174,494
Credit institutions	11,067	(2)	–	–	–	11,065
Other financial corporations	483	–	–	–	–	483
Non-financial corporations	3	–	–	–	–	3
Loans and advances to banks	**320,717**	**(16)**	**–**	**–**	**–**	**320,701**
Central banks	290,452	(2)	–	–	–	290,450
Credit institutions	30,265	(14)	–	–	–	30,251
Loans and advances to customers	**709,160**	**(1,848)**	**(1,739)**	**(9,422)**	**(100)**	**696,051**
General governments	17,835	(2)	(51)	–	–	17,782
Other financial corporations	43,853	(28)	(18)	(132)	–	43,675
Non-financial corporations	262,975	(1,067)	(735)	(5,178)	(90)	255,905
Households	384,497	(751)	(935)	(4,112)	(10)	378,689
Total	**1,215,939**	**(1,881)**	**(1,739)**	**(9,422)**	**(100)**	**1,202,797**

Allowances for financial assets at amortised cost – debt securities

In CZK million	As of	Increases due to origination and acquisition	Decreases due to derecognition	Net changes due to change in creditrisk	Transfers between Stage 1 and Stages 2/3	Net changes due to modifications without derecognition	Decrease in allowance account due to write-offs	Other adjustments	As of
	1 Jan 18								**30 Jun 18**
Stage 1	**(18)**	**(2)**	**4**	**(49)**	**47**	**–**	**–**	**1**	**(17)**
Central banks	–	(2)	2	(1)	–	–	–	1	–
General governments	(10)	–	–	(5)	–	–	–	–	(15)
Credit institutions	(8)	–	1	5	–	–	–	–	(2)
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	–	–	1	(48)	47	–	–	–	–
Stage 2	**(51)**	**(50)**	**50**	**51**	**–**	**–**	**–**	**–**	**–**
Non-financial corporations	(51)	(50)	50	51	–	–	–	–	–
Total	**(69)**	**(52)**	**54**	**2**	**47**	**–**	**–**	**1**	**(17)**

Allowances for financial assets at amortised cost – loans and advances to banks

In CZK million	As of	Increases due to origination and acquisition	Decreases due to derecognition	Net changes due to change in creditrisk	Transfers between Stage 1 and Stages 2/3	Net changes due to modifications without derecognition	Decrease in allowance account due to write-offs	Other adjustments	As of
	1 Jan 18								30 Jun 18
Stage 1	(23)	(69)	118	(35)	(12)	–	–	5	(16)
Central banks	(9)	(9)	23	(7)	–	–	–	–	(2)
Credit institutions	(14)	(60)	95	(28)	(12)	–	–	5	(14)
Stage 2	–	(2)	2	8	(8)	–	–	–	–
Central banks	–	–	–	–	–	–	–	–	–
Credit institutions	–	(2)	2	8	(8)	–	–	–	–
Total	(23)	(71)	120	(27)	(20)	–	–	5	(16)

Allowances for financial assets at amortised cost – loans and advances to customers

In CZK million	As of	Increases due to origination and acquisition	Decreases due to derecognition	Net changes due to change in creditrisk	Transfers between Stage 1 and Stages 2/3	Net changes due to modifications without derecognition	Decrease in allowance account due to write-offs	Other adjustments	As of
	1 Jan 18								30 Jun 18
Stage 1	(1,951)	(374)	571	(4,379)	4,199	–	13	73	(1,848)
General governments	–	(9)	2	(62)	67	–	–	–	(2)
Other financial corporations	(36)	(28)	41	(10)	3	–	–	2	(28)
Non-financial corporations	(1,172)	(274)	466	(1,554)	1,396	–	–	71	(1,067)
Households	(743)	(63)	62	(2,753)	2,733	–	13	0	(751)
Stage 2	(2,438)	(434)	203	4,609	(3,728)	–	12	37	(1,739)
General governments	(28)	(150)	–	206	(93)	–	–	14	(51)
Other financial corporations	(26)	(16)	22	4	(1)	–	–	(1)	(18)
Non-financial corporations	(1,380)	(88)	147	1,366	(768)	–	–	(12)	(735)
Households	(1,004)	(180)	34	3,033	(2,866)	–	12	36	(935)
Stage 3	(9,148)	(36)	447	(261)	(273)	–	196	(347)	(9,422)
General governments	–	–	–	–	–	–	–	–	–
Other financial corporations	(129)	–	–	(3)	–	–	–	–	(132)
Non-financial corporations	(5,030)	(13)	249	(53)	(124)	–	72	(279)	(5,178)
Households	(3,989)	(23)	198	(205)	(149)	–	124	(68)	(4,112)
POCI	(123)	(29)	–	46	–	–	–	6	(100)
General governments	–	–	–	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	(121)	(24)	–	49	–	–	–	6	(90)
Households	(2)	(5)	–	(3)	–	–	–	–	(10)
Total	(13,660)	(873)	1,221	15	198	–	221	(231)	(13,109)

26. Finance lease receivables

in CZK million	Gross carrying amount	Credit loss allowances				Net carrying amount
Jun 18		Stage 1	Stage 2	Stage 3	POCI	
General governments	3	–	–	–	–	3
Other financial corporations	14	–	–	–	–	14
Non-financial corporations	1,953	(10)	(12)	(124)	–	1,807
Households	270	(2)	(2)	(24)	–	242
Total	2,240	(12)	(14)	(148)	–	2,066

Allowances for finance lease receivables

In CZK million	As of	Increases due to origination and acquisition	Decreases due to derecognition	Net changes due to change in creditrisk	Transfers between Stage 1 and Stages 2/3	Net changes due to modifications without derecognition	Decrease in allowance account due to write-offs	Other adjustments	As of
	1 Jan 18								30 Jun 18
Stage 1	(12)	(3)	–	(11)	14	–	–	–	(12)
General governments	–	–	–	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	(9)	(2)	–	(10)	11	–	–	–	(10)
Households	(3)	(1)	–	(1)	3	–	–	–	(2)
Stage 2	(26)	(1)	1	18	(6)	–	–	–	(14)
General governments	–	–	–	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	(21)	(1)	1	15	(6)	–	–	–	(12)
Households	(5)	–	–	3	–	–	–	–	(2)
Stage 3	(106)	(12)	5	(30)	(5)	–	–	–	(148)
General governments	–	–	–	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	(88)	(11)	5	(25)	(5)	–	–	–	(124)
Households	(18)	(1)	–	(5)	–	–	–	–	(24)
POCI	–	–	–	–	–	–	–	–	–
General governments	–	–	–	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	–	–	–	–	–	–	–	–	–
Households	–	–	–	–	–	–	–	–	–
Total	(144)	(16)	6	(23)	3	–	–	–	(174)

27. Derivatives – hedge accounting

	As of 30 June 2018			As of 31 December 2017		
in CZK million	Notional value	Positive fair value	Negative fair value	Notional value	Positive fair value	Negative fair value
Fair value hedges	13,410	36	(3)	11,893	12	(20)
Interest rate	13,410	36	(3)	11,893	12	(20)
Cash flow hedge	107,082	148	(2,728)	90,690	601	(1,793)
Interest rate	76,757	47	(1,993)	61,560	253	(1,686)
Foreign exchange	30,325	101	(735)	29,130	348	(107)
Total	120,492	184	(2,731)	102,583	613	(1,813)

28. Trade and other receivables

in CZK million		Credit loss allowances				
Jun 18	Gross carrying amount	Stage 1	Stage 2	Stage 3	POCI	Net carrying amount
General governments	197	(11)	(148)	–	–	38
Credit institutions	42	–	(12)	–	–	30
Other financial corporations	2	–	(2)	–	–	–
Non-financial corporations	9	–	(1)	(5)	–	3
Households	185	–	(118)	(10)	–	57
Total	435	(11)	(281)	(15)	–	128

Allowances for trade and other receivables

In CZK million	As of	Increases due to origination and acquisition	Decreases due to derecognition	Net changes due to change in creditrisk	Transfers between Stage 1 and Stages 2/3	Net changes due to modifications without derecognition	Decrease in allowance account due to write-offs	Other adjustments	As of
	1 Jan 18								30 Jun 18
Stage 1	**(18)**	**(2)**	**9**	**–**	**–**	**–**	**–**	**–**	**(11)**
General governments	(9)	(2)	–	–	–	–	–	–	(11)
Credit institutions	(9)	–	9	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	–	–	–	–	–	–	–	–	–
Households	–	–	–	–	–	–	–	–	–
Stage 2	**(228)**	**(55)**	**2**	**–**	**–**	**–**	**–**	**–**	**(281)**
General governments	(150)	–	2	–	–	–	–	–	(148)
Credit institutions	–	(12)	–	–	–	–	–	–	(12)
Other financial corporations	(1)	(1)	–	–	–	–	–	–	(2)
Non-financial corporations	–	(1)	–	–	–	–	–	–	(1)
Households	(77)	(41)	–	–	–	–	–	–	(118)
Stage 3	**(7)**	**(8)**	**–**	**–**	**–**	**–**	**–**	**–**	**(15)**
General governments	–	–	–	–	–	–	–	–	–
Credit institutions	–	–	–	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	(5)	–	–	–	–	–	–	–	(5)
Households	(2)	(8)	–	–	–	–	–	–	(10)
POCI	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
General governments	–	–	–	–	–	–	–	–	–
Credit institutions	–	–	–	–	–	–	–	–	–
Other financial corporations	–	–	–	–	–	–	–	–	–
Non-financial corporations	–	–	–	–	–	–	–	–	–
Households	–	–	–	–	–	–	–	–	–
Total	(253)	(65)	11	–	–	–	–	–	(307)

29. Other assets

in CZK million	Jun 2018	Dec 2017
Prepayments and accrued income	87	324
Assets under construction/unfinished goods/inventory	130	131
Sundry assets	1,690	1,652
Other assets	**1,907**	**2,107**

30. Financial liabilities at fair value through profit and loss

in CZK million	Jun 2018	Dec 2017
Deposits	1,452	1,240
Other financial corporations	39	–
Non financial corporations	17	2
Households	1,396	1,238
Financial liabilities at fair value through profit and loss	**1,452**	**1,240**

31. Financial liabilities at amortised costs

Deposits from banks

in CZK million	Jun 2018	Dec 2017
Overnight deposits	38,962	14,852
Term deposits	91,879	124,464
Repurchase agreements	236,921	155,916
Deposits from banks	**367,762**	**295,232**

Deposits from customers

in CZK million	Jun 2018	Dec 2017
Current accounts/Overnight deposits	784,839	746,262
General governments	80,985	62,372
Other financial corporations	25,112	31,506
Non financial corporations	120,788	124,667
Households	557,954	527,717
Term deposits	108,550	109,044
General governments	98	31
Other financial corporations	10,733	15,676
Non financial corporations	6,700	2,910
Households	91,019	90,427
Repurchase agreements	24,877	26,691
General governments	–	–
Other financial corporations	24,557	26,306
Non financial corporations	320	385
Deposits from customers	**918,266**	**881,997**
General governments	81,083	62,403
Other financial corporations	60,402	73,488
Non financial corporations	127,808	127,962
Households	648,973	618,144

Debt securities issued – Bonds

in CZK million	ISIN	Date of issue	Maturity	Interest rate	Bonds Traded on regulated market Yes/No	Jun 2018	Dec 2017
Mortgage bonds	CZ0002001407	December 2007	December 2022	floating	Yes	17	19
Mortgage bonds	CZ0002001415	November 2007	November 2023	6.15%	Yes	452	445
Mortgage bonds	CZ0002001654	December 2007	December 2022	floating	No	54	60
Mortgage bonds	CZ0002002744	December 2012	December 2021	2.75%	No	100	81
Mortgage bonds	CZ0002002751	December 2012	June 2023	3.25%	No	219	178
Mortgage bonds	CZ0002002777	December 2012	June 2018	1.75%	No	–	40
Mortgage bonds	CZ0002002785	December 2012	December 2019	2.50%	No	92	80
Promissory note	1950087	December 2017	January 2018			–	400
Promissory note	1950084	December 2017	January 2018			–	500
Cumulative change in carrying amount due to fair value hedging						1	2
Bonds issued						**935**	**1,805**

32. Provisions

in CZK million	Jun 2018	Dec 2017
Restructuring	97	107
Pending legal issues	1,849	1,843
Commitments and guarantees given	913	784
Provisions for guarantees – off balance (defaulted customers)	–	423
Provisions for guarantees – off balance (non defaulted customers)	–	361
Provisions for commitments and financial guarantees in Stage 1	247	–
Provisions for commitments and financial guarantees in Stage 2	124	–
Provisions for commitments and financial guarantees – Defaulted	542	–
Other provisions	44	44
Provisions for onerous contracts	8	8
Other	36	36
Provisions	**2,903**	**2,778**

33. Other liabilities

in CZK million	Jun 2018	Dec 2017
Deferred income and accrued expenses	269	235
Sundry liabilities	9,129	10,530
Other liabilities	**9,398**	**10,765**

34. Segment reporting

The Group's segment reporting is compliant with IFRS 8 Operating Segments, which adopts the management approach. Segment information is prepared on the basis of internal management reporting that is regularly reviewed by the chief operating decision maker to assess the performance of the segments and make decisions regarding the allocation of resources. Within the Group the function of the chief operating decision maker is exercised by the Management Board of Česká spořitelna, a.s.

Structure of Business Segments

The segment reporting comprises four operating segments reflecting the Group's management structure.

Business segments

Retail	Corporates	ALM & CC	Group Markets

Retail

Retail segment comprises the business activities which are in the responsibility of account managers in the Retail network. Targeted customers are mainly privates, micros and free professionals. This business is mainly operated in cooperation with subsidiaries such as Leasing, Asset Management with the focus on simple products ranged from loans, investment products, current accounts and savings products to credit cards and cross selling products such as leasing, insurance, building society products.

In addition, the retail segment contains the results of the subsidiaries Stavební spořitelna České spořitelny, a.s., Česká spořitelna penzijní společnost, a.s., Věrnostní program iBod, a.s, Energie ČS, a.s., Holding Card Service, s.r.o. and MOPET CZ, a.s.

Corporates

Corporates segment comprises the business activities done with corporate customers of different turnover size and public sector.

Small and medium-sized enterprises (SME) are clients which are under the responsibility of the corporate commercial center network, mainly consisting of companies with an annual turnover from CZK 60 million to CZK 2 billion.

Local Large Corporates are clients with a consolidated annual turnover threshold above CZK 2 billion which are not defined as Group Large Corporate customers.

Group Large Corporates are large corporate customers/client groups with substantial operations in core markets/extended core markets of Erste Group with an indicative consolidated annual turnover generally of at least EUR 500 million.

Public Sector consists of the following three sets of customers: public sector, public corporations and non-profit sector.

Public sector includes such customers as central ministries and state funded funds and agencies, non-profit entities established by or under control of central government entities, regional governments and organizations funded by them, state capitals, public health and social insurance companies. In general, Public sector excludes banks and non-bank financial institutions (FI), pension funds, bond issuing agencies (incl. government debt agencies), asset management based organizations which are part of the Group Markets segment.

Public corporations includes all non-financial state companies and corporations with more than 50% share of state or regional governments or municipals excluding stock exchange listed companies.

Non-profit sector comprises the following private non-profit companies: central authorities of churches, labor unions and nationally significant foundations, private schools and humanitarian organizations.

Commercial Real Estate covers commercial property projects financed by the Group.

In addition, the segment Corporates contains the results of the subsidiaries Factoring České spořitelny, a.s., Erste Leasing, a.s., REICO investiční společnost České spořitelny, a.s., s Autoleasing, a.s., s Autoleasing SK, s.r.o. and Erste Grantika Advisory, a.s.

Asset and Liability Management & Local Corporate Center (ALM & CC)

Asset Liability Management (ALM) comprises the management of bank assets and liabilities in the light of uncertainty of cash flows, cost of funds and return on investments in order to determine the optimal trade-off between risk, return and liquidity. Furthermore it comprises funding transactions, hedging activities, investments into securities other than held for trading purpose, management of own issues and FX positions.

Local Corporate Center (CC) comprises all non-core banking business activities such as non-profit servicing participations (e.g. IT, Procurement, Facility Management), intragroup eliminations within the Group, dividends, refinancing costs of participations, all non-banking statement of financial position positions (e.g. fixed assets, intangible assets) which cannot be allocated to other business segments as well as the profit and loss positions resulting from these statement of financial position items. Apart from that the Corporate Center includes Free Capital of the Group defined as the difference of the total IFRS equity and the economical equity allocated to all operating segments.

Corporate center also includes results of the subsidiaries Brokerjet České spořitelny, a.s., Czech TOP Venture Fund B.V., ČS NHQ, s.r.o. and s IT Solutions CZ, s.r.o.

Group Markets

Group Markets segment comprises trading and markets services as well as business with financial institutions.

Trading and Market services includes all activities related to active risk taking and managing in regulatory trading books of the Group, additional to that the execution of trades against the market using the trading books of the Group for market making and short-term liquidity management. Specifically revenues and fair value results not directly attributable to client transactions and generally risk premiums and execution fees are taken into account.

Financial institutions are companies that provide financial services for their clients or members and act as professional and active participant on financial markets for the purpose of proprietary trading or on behalf of their clients (banks, central banks, development banks, investment banks, investment funds, brokerages, insurance companies, pension funds, credit unions, building societies, asset management companies, government debt agencies, sovereign wealth funds, exchanges).

Business connected with serving financial institutions as a client including custody, depository services, commercial business (loans, cash management, trade & export finance) and capital markets business belongs to FI.

Measurement

Intersegment transactions are conducted on an arm's length basis. Intersegment settlements are subject of funds transfer pricing dependent on market interest rates. Due to the specifics of the banking business the internal charges are not reported separately and Board of Directors primarily refers to net interest income of operating segments. Non-manageable general administrative expenses are reallocated to operating segments as indirect costs.

Comparability of 2018 and 2017 figures

The adjustment of the methodology of the cost of capital calculation including capital benefit effective from 1 January 2018 affected the split of the net interest income as well as average allocated capital between the business segments. 2017's figures were not retrospectively adjusted due to this change.

Business segments

	Retail		Corporates		Group Markets		ALM&CC		Total Group	
in CZK million	**1–6 2018**	**1–6 2017**	**1–6 2018**	**1–6 2017**	**1–6 2018**	**1–6 2017**	**1–6 2018**	**1–6 2017**	**1–6 2018**	**1–6 2017**
Net interest income	9,694	9,569	2,868	2,707	448	100	134	(31)	13,144	12,345
Net fee and commission income	3,325	3,417	636	667	639	620	(313)	(231)	4,287	4,473
Dividend income	–	–	–	7	–	–	50	39	50	46
Net trading result	538	694	341	419	424	570	(262)	(263)	1,041	1,420
Gains/losses from financial instruments at FVPL	–	–	–	–	–	–	–	(18)	–	(18)
Net result from equity method investments	–	–	–	–	–	–	2	(12)	2	(12)
Rental income from investment properties & other operating leases	–	3	83	129	–	–	28	27	111	159
General administrative expenses	(7,146)	(6,964)	(1,426)	(1,430)	(325)	(307)	(263)	(320)	(9,160)	(9,021)
Gains/losses from financial assets and liabilities not at FVPL, net	–	(1)	–	–	–	–	–	270	–	269
Gains/losses from derecognition of financial assets at AC	(12)	–	–	–	–	–	18	–	6	–
Other gains/losses from derecognition of financial instruments not at FVPL	–	–	–	–	–	–	24	–	24	–
Net impairment loss on financial assets	–	(159)	–	152	–	–	–	272	–	265
Impairment result from financial instruments	(17)	–	896	–	9	–	15	–	903	–
Other operating result	78	38	(84)	(137)	(187)	(96)	(366)	(173)	(559)	(368)
Pre-tax result from continuing operations	6,460	6,597	3,314	2,514	1,008	887	(933)	(440)	9,849	9,558
Taxes on income	(1,209)	(1,247)	(630)	(459)	(192)	(169)	39	(16)	(1,992)	(1,891)
Net result for the period	5,251	5,350	2,684	2,055	816	718	(894)	(456)	7,857	7,667
Net result attributable to non-controlling interests	–	–	–	–	–	–	(13)	(6)	(13)	(6)
Net result attributable to owners of the parent	5,251	5,350	2,684	2,055	816	718	(881)	(450)	7,870	7,673
Operating income	13,557	13,683	3,928	3,929	1,511	1,290	(361)	(489)	18,635	18,413
Operating expenses	(7,146)	(6,964)	(1,426)	(1,430)	(325)	(307)	(263)	(320)	(9,160)	(9,021)
Operating result	6,411	6,719	2,502	2,499	1,186	983	(624)	(809)	9,475	9,392
Risk-weighted assets (credit risk, eop)	172,104	151,031	262,508	232,374	11,995	13,154	35,836	22,212	482,443	418,771
Average allocated capital	25,385	18,989	22,490	18,198	2,851	3,102	82,840	83,241	133,566	123,530
Cost/income ratio	52.7%	50.9%	36.3%	36.4%	21.5%	23.8%	(72.9%)	(65.4%)	49.2%	49.0%
Return on allocated capital	41.4%	56.3%	23.9%	22.6%	57.2%	46.3%	(2.2%)	(1.1%)	11.8%	12.4%
Total assets (eop)	458,524	423,764	285,245	253,277	219,644	41,825	468,397	528,705	1,431,810	1,247,571
Total liabilities excluding equity (eop)	681,262	632,136	208,328	192,207	317,713	96,931	109,946	210,300	1,317,249	1,131,574

eop = end of period

The majority of revenue from external customers is generated in the Czech Republic.

35. Related party transactions

Related parties involve connected entities or parties that have a special relationship to the Group.

Parties are considered to be related if one party has the ability to control the other or exercise significant influence over the other in making financial or operational decisions. The Group is controlled by Erste Group Bank AG.

The parties that have a special relationship to the Group are considered to be members of the Group's statutory and supervisory bodies and management, legal entities exercising control over the Group (including entities with a qualified interest in these entities and management of these entities), persons closely related to the members of the Group's statutory and supervisory bodies, management, and entities exercising control over the Group, legal entities in which any of the parties listed above holds a qualified interest, entities with a qualified interest in the Group and any other legal entity under their control, members of the CNB's Banking Board, and legal entities which the Group controls.

Pursuant to the definitions outlined above, the categories of the Group's related parties principally comprise Erste Group Bank, members of its Board of Directors and Supervisory Board, and other related parties, which include companies directly or indirectly controlled by Erste Group Bank.

A number of banking transactions are entered into with related parties in the normal course of business. These principally include loans, deposits and other transactions. These transactions were carried out on an arm's length basis and were settled exclusively in cash. The interest rates charged to and by related parties are at normal commercial rates. Outstanding balances are unsecured.There were no provisions for doubtful debts related to the outstanding balances with Related Parties reported by the Group (as of Jun 2018 and Dec 2017).

Loans and advances to and amounts owed to related parties

			Jun 2018			Dec 2017
in CZK million	**Erste Group Bank AG**	**Other related parties**	**Members of the Board of Directors and Supervisory Board**	**Erste Group Bank AG**	**Other related parties**	**Members of the Board of Directors and Supervisory Board**
Assets						
Cash and cash balances	1,271	40	–	661	55	–
Financial assets - held for trading	3,332	–	–	5,038		–
Financial assets at amortised costs	17,561	296	29	–	–	–
Trade and other receivables	29	1	–	–	–	
Loans and receivables to credit institutions	–	–	–	14,908	–	–
Loans and receivables to customers	–	–	–	–	307	22
Derivatives Hedge Accounting	158	–	–	377	–	–
Other assets	378	2	–	24	39	–
Liabilities						
Financial liabilities held for trading	5,030	–	–	2,949	–	–
Financial liabilities measured at amortised costs	311,579	1,382	33	250,029	3,355	39
Derivatives Hedge Accounting	553	–	–	69	–	–
Other Liabilities	120	373	–	92	238	–
Loans commitments, financial guarantees and other commitments given	**450**	**6**	**–**	**–**	**–**	**–**
Loan commitments, financial guarantees and other commitments received	**785**	**2**	**–**	**22**	**53**	**–**
Profit & Loss statement		**1–6 2018**			**1–6 2017**	
Net interest income	(156)	1	–	195	2	–
Net fee and commision income	11	367	–	16	336	–
Dividend income	–	–	–	–	42	–
Net trading and fair value result	(3,676)	–	–	3,287	–	–
Rental income from investment properties & other operating lease	–	7	–	–	3	–
Other administrative expenses	(141)	(427)	–	(150)	(276)	–
Other operating result	11	4	–	10	9	–

36. Risk management

It is a core function of every bank to take risks in a conscious and selective manner and to manage such risks professionally. TheGroup's proactive risk policy and strategy aims at achieving balanced risk and return in order to generate a sustainable and adequate return on equity. Concerning risk policy and strategy as well as regarding risk management organisation, reference is made to the chapter of the same name in the annual consolidated financial statements as of 31. December 2017.

Credit risk

The classification of credit assets into risk grades is based on the Group's internal ratings. For the purpose of external reporting, internal rating grades of the Group are grouped into the following four risk categories:

Low risk

Typically regional customers with well-established and rather long-standing relationships with the Group or large internationally recognised customers. Very good to satisfactory financial position and low likelihood of financial difficulties relative to the respective market in which the customers operate. Retail clients having long relationships with the bank, or clients with a wide product pool use. No relevant late payments currently or in the most recent 12 months. New business is generally with clients in this risk category.

Management attention

Vulnerable non-retail clients, which may have overdue payments or defaults in their credit history or may encounter debt repayment difficulties in the medium term. Retail clients with possible payment problems in the past triggering early collection reminders. These clients typically have a good recent payment history.

Substandard

The borrower is vulnerable to short term negative financial and economic developments and shows an elevated probability of failure. In some cases, restructuring measures are possible or already in place. As a rule, such loans are managed in specialised risk management departments.

Non-performing

One or more of the default criteria under Article 178 of the CRR are met: among others, full repayment unlikely, interest or principal payments on a material exposure more than 90 days past due, restructuring resulting in a loss to the lender, realisation of a loan loss, or initiation of bankruptcy proceedings. The Group applies the customer view for all customer segments, including retail clients; if an obligor defaults on one deal then the customer's performing transactions are classified as non-performing as well. Furthermore, non-performing exposures also comprise non-performing forborne transactions even in cases where the client has not defaulted.

Credit risk exposure

- cash and cash balances – other demand deposits to credit institutions;
- financial assets held for trading (without equity instruments);
- non-trading financial assets at fair value through profit or loss (FVPL) (without equity instruments);
- financial assets at fair value through other comprehensive income (FVOCI) (without equity instruments);
- financial assets at amortised cost (AC);
- assets held for sale – financial instruments;
- finance lease receivables;
- positive fair value of hedge accounting derivatives;
- trade and other receivables;
- off-balance sheet exposures (financial guarantees, irrevocable loan and other commitments).

The credit risk exposure comprises the gross carrying amount (or nominal value in the case of off-balance-sheet exposures) without taking into account loan loss allowances, provisions for guarantees, any collateral held (including risk transfer to guarantors), netting effects, other credit enhancements or credit risk mitigating transactions.

The gross carrying amount of the credit risk exposure increased to CZK 1,431,633 million from CZK 1,174,918 million.

a) Structure of Credit Risk by On-balance Sheet and Off-balance Sheet Items

The Group is exposed to credit risk arising from the following items:

in CZK million	Jun 2018	Dec 2017
Credit risk NET exposures relating to on-balance sheet items		
Other demand deposits	1,828	2,100
Financial assets held for trading – derivatives	11,438	11,301
Financial assets held for trading – debt securities	505	132
Financial assets designated at fair value through profit or loss – debt securities	-	354
Non-trading financial assets at FVPL – debt securities	688	-
Non-trading financial assets at FVPL – loans and advances	67	-
Available-for-sale financial assets – debt securities	-	53,566
Financial assets at FVOCI – debt securities	51,143	
Loans and receivables to credit institutions	-	157,525
Loans and receivables to customers	-	638,694
General governments	-	17,171
Other financial corporations	-	18,306
Non-financial corporations	-	240,747
Households	-	362,470
Financial assets at amortised costs – debt securities	186,045	-
Financial assets at amortised costs – loans and advances to banks	320,701	-
Financial assets at amortised costs – loans and advances to customers	696,051	-
Held-to-maturity investments	-	163,679
Derivatives – Hedge accounting	184	613
Finance lease receivables	2,066	-
Trade and other receivables	128	-
Credit risk exposure relating to off-balance sheet items		
Irrevocable financial guarantees given	22,491	19,461
Irrevocable loan commitments given	124,635	115,052
Total	**1,417,970**	**1,162,477**

Collateral securing the above receivables is as follows:

in CZK million	Jun 2018	Dec 2017
Loans and advances to credit institutions	280,958	133,663
Loans and advances to customers	346,190	299,061
Total	**627,148**	**432,724**

b) Credit risk exposure by financial instrument

The following tables present Group's credit risk exposure by counterparty sector, broken down by financial instruments, as of each reporting date indicated.

Credit risk exposure by counterparty sector and financial instrument in June 2018

					At amortised cost							
in CZK million	**Cash and cash balances – other demand deposits to credit institutions**	**Financial assets held for trading**	**Non-trading financial assets at FVPL**	**Financial assets at FVOCI**	**Debt securities**	**Loans and advances to banks**	**Loans and advances to customers**	**Finance lease receivables**	**Positive fair value of derivatives**	**Trade and other receivables**	**Off balance-sheet exposures**	**Gross exposure**
Jun 18												
Central banks	–	–	–	–	–	290,452	–	–	–	–	–	290,452
General governments	–	2,479	–	36,236	174,509	–	17,835	3	–	197	9,657	240,916
Credit institutions	1,831	5,730	281	5,883	11,067	30,265	–	–	171	42	849	56,119
Other financial corporations	–	1,228	439	1,354	483	–	43,853	14	–	2	3,558	50,931
Non-financial corporations	–	2,489	35	7,707	3	–	262,975	1,953	13	9	74,200	349,384
Households	–	17	–	–	–	–	384,497	270	–	185	58,862	443,831
Total	**1,831**	**11,943**	**755**	**51,180**	**186,062**	**320,717**	**709,160**	**2,240**	**184**	**435**	**147,126**	**1,431,633**

Credit risk exposure by Basel 3 exposure class and financial instrument in December 2017

				Debt instruments							
in CZK million	**Cash and cash balances – other demand deposits to credit institutions**	**Loans and advances to credit institutions**	**Loans and advances to customers**	**Financial assets – held to maturity**	**Financial assets – held for trading**	**Financial assets – at fair value through profit or loss**	**Financial assets – available for-sale**	**Positive fair value of derivatives**	**Contingent credit risk liabilities**	**Gross exposure**
			At amortised cost			Fair value				
Sovereign	–	135,515	15,842	159,494	91	289	40,272	2,817	6,813	361,133
Institutions	2,100	22,047	–	3,716	41	–	3,417	7,875	583	39,779
Corporates	–	–	247,824	474	–	65	9,877	1,222	68,390	327,852
Retail	–	–	387,427	–	–	–	–	–	58,727	446,154
Total	**2,100**	**157,562**	**651,093**	**163,684**	**132**	**354**	**53,566**	**11,914**	**134,513**	**1,174,918**

Credit risk exposure by Basel 3 exposure class and financial instrument in June 2018

					At amortised cost							
in CZK million	**Cash and cash balances – other demand deposits to credit institutions**	**Financial assets held for trading**	**Non-trading financial assets at FVPL**	**Financial assets at FVOCI**	**Debt securities**	**Loans and advances to banks**	**Loans and advances to customers**	**Finance lease receivables**	**Positive fair value of derivatives**	**Trade and other receivables**	**Off balance-sheet exposures**	**Gross exposure**
Jun 18												
Sovereigns	–	2,474	37	36,232	174,509	290,452	17,276	3	–	48	8,986	530,017
Institutions	1,831	5,730	281	5,887	11,067	30,265	111	–	171	30	849	56,223
Corporates	–	3,723	436	9,061	486	–	286,453	1,967	13	308	74,327	376,774
Retail	–	16	–	–	–	–	405,320	270	–	49	62,964	468,619
Total	**1,831**	**11,943**	**755**	**51,180**	**186,062**	**320,717**	**709,160**	**2,240**	**184**	**435**	**147,126**	**1,431,633**

The assignment of obligors to Basel 3 exposure classes is based on legal regulations. For reasons of clarity, individual Basel 3 exposure classes are presented in aggregated form. The aggregated exposure class 'sovereigns' also contains regional and local governments as well as public sector entities in addition to central governments, central banks, international organisations and multinational development banks. Institutions include banks and recognised investment firms.

c) Credit risk exposure by risk category

Credit risk exposure by industry and risk category

The following tables present the credit risk exposure of the Group broken down by industry and risk category as of 31 December 2017 and 30 June 2018, respectively.

Gross credit risk exposure by industry and risk category in December 2017

in CZK million	Low risk	Management attention	Substandard	Non-performing	Credit risk exposure
Agriculture and forestry	14,446	3,460	194	334	18,434
Mining	1,577	177	–	–	1,754
Manufacturing	70,185	8,097	2,047	3,157	83,486
Energy and water supply	24,529	2,408	72	602	27,611
Construction	17,617	3,863	915	947	23,342
Trade	42,338	9,165	957	2,335	54,795
Transport and communication	22,682	4,478	106	180	27,446
Hotels and restaurants	3,577	2,550	171	219	6,517
Financial and insurance services	207,511	3,014	1	247	210,773
Real estate and housing	71,071	12,850	277	823	85,021
Services	20,595	6,055	330	689	27,669
Public administration	213,888	602	–	–	214,490
Education, health and art	5,960	1,172	17	111	7,260
Private households	367,780	12,098	1,398	5,044	386,320
Total	**1,083,756**	**69,989**	**6,485**	**14,688**	**1,174,918**

Gross credit risk exposure by industry and risk category in June 2018

in CZK million	Low risk	Management attention	Substandard	Non-performing	Total
Agriculture and forestry	14,977	3,180	218	315	18,690
Mining	1,256	42	–	101	1,399
Manufacturing	79,121	8,830	539	3,737	92,227
Energy and water supply	25,190	1,459	41	579	27,269
Construction	20,197	4,409	1,005	1,756	27,367
Trade	45,783	10,227	375	2,070	58,455
Transport and communication	26,123	4,296	169	143	30,731
Hotels and restaurants	5,776	2,540	174	201	8,691
Financial and insurance services	391,287	3,489	5	241	395,022
Real estate and housing	79,310	10,816	222	573	90,921
Services	22,635	4,990	340	751	28,716
Public administration	238,710	1,113	–	–	239,823
Education, health and art	6,201	1,086	38	109	7,434
Households	370,717	27,331	1,353	5,487	404,888
Total	**1,327,283**	**83,808**	**4,479**	**16,063**	**1,431,633**

Gross Credit risk exposure by industry and IFRS 9 stage

in CZK million	Stage 1 – 12-month expected credit loss	Stage 2 – Lifetime expected credit loss	Stage 3 (default) – Lifetime expected credit loss	POCI	Simplified Approach	Not subject to impairment	Total
June 18							
Agriculture and forestry	17,048	1,314	302	6	–	20	18,690
Mining	1,223	4	101	–	–	71	1,399
Manufacturing	80,217	7,149	3,627	93	–	1,141	92,227
Energy and water supply	25,511	838	573	5	–	342	27,269
Construction	23,666	2,070	1,587	36	–	8	27,367
Trade	51,122	5,027	2,027	35	–	244	58,455
Transport and communication	26,117	4,210	141	–	–	263	30,731
Hotels and restaurants	7,927	528	188	9	–	39	8,691
Financial and insurance services	372,719	14,202	241	–	–	7,860	395,022
Real estate and housing	82,497	7,582	547	–	–	295	90,921
Services	24,750	3,164	727	6	–	69	28,716
Public administration	234,486	2,864	–	–	–	2,473	239,823
Education, health and art	6,903	420	66	–	–	45	7,434
Households	387,523	12,038	5,281	34	–	12	404,888
Total	**1,341,709**	**61,410**	**15,408**	**224**	**–**	**12,882**	**1,431,633**

Stage 1 and Stage 2 comprise not impaired credit risks while Stage 3 includes impaired credit risks. POCI (purchased or originated credit impaired) consists of credit risks already impaired when purchased or originated.

The defaulted part of POCI amounted to CZK 185 million, the non-defaulted part to CZK 39 million.

General principles for credit loss allowances

The general principles and standards for credit loss allowances are governed by internal policies in the Group. According to IFRS 9, credit loss allowances are calculated for all components of the credit risk exposure which are measured at amortized cost (AC) or at fair value through other comprehensive income and include other demand deposits, debt securities, loans and advances as well as finance lease and trade receivables. Provisions for loan commitments and financial guarantees are calculated if they are IFRS 9 impairment relevant.

In the area of expected credit loss (ECL) modelling and calculation of ensuing credit loss allowances (CLA), the Group has concluded that one of the key drivers of the expected impact from adopting the ECL model required by IFRS 9 is the assessment of significant increase in credit risk (SICR) for exposures that are not identified as credit-impaired as at the date of initial application of IFRS 9 (for retrospective application) or as at any given reporting period after transition to IFRS 9 (for prospective application). In this respect, across portfolios and product types, quantitative and qualitative indicators are defined for assessing SICR, including the indicator of 30 days-past-due.

Quantitative indicators include adverse changes in annualized lifetime probability of default and in 12-month probability of defaults with significance being assessed by reference to a mix of relative and absolute change thresholds. Generally the indicators for probability of default are determined to reflect the risk as a "point-in-time" measure and with consideration of forward-looking information ("FLI"). The thresholds are established at PD segment level or client rating level, as necessary, and are subject to initial and on-going validation.

Qualitative SICR indicators include forbearance-type flags, work-out transfer flag, information from early-warning-system (if it is not sufficiently considered in rating) and fraud indicators. The assignment of some of the qualitative indicators inherently relies on experienced credit risk judgment being exercised adequately and timely. The related group-wide and entity-level credit risk controlling policies and procedures (adapted as necessary in the light of transition to IFRS 9) ensure the necessary governance framework.

The "low credit risk exemption" allowed by IFRS 9 for "investment grade" assets or other assets deemed "low risk" (and resulting in 12 months expected credit losses being calculated irrespective of SICR quantitative measures) has been implemented with limitations in the Group. Thus, the potential activation of this exemption is limited to particular types of debt instruments and counterparty categories, and only if supported by sufficient "low risk" evidence. On this basis, the "low risk exemption" is expected to occasionally apply to some debt security exposures and only exceptionally to loans.

The calculation of credit loss allowances is done on a daily basis on single exposure level and in the contractual currency of the exposure. To compute the credit loss allowance, the Group applies an expected credit loss (ECL) model based on a three stages approach that either leads to a twelve-month ECL or to a lifetime ECL.

The three stages approach applies to financial instruments which are not categorized as purchased or originated credit-impaired financial

assets which form a category on their own. Depending on the impairment status and the assessment of the development of credit risk, the financial instruments are assigned to one of three stages.

Stage 1 includes financial instruments at initial recognition and financial assets without a significant increase in credit risk since initial recognition irrespective of their credit quality. In stage 1, the credit risk loss allowances are calculated as twelve-months ECL.

Stage 2 includes financial instruments with a significant increase in credit risk but not credit-impaired at the reporting date. In stage 2, the credit risk loss allowances are calculated as lifetime ECL.

Stage 3 includes financial assets which are credit-impaired at the reporting date. In principle, a financial instrument becomes credit-impaired when the customer defaults. The Group generally applies a customer view which leads to an impairment of all claims even if the customer defaults only on one of several transactions. On the other side, an upgrade to a non-defaulted rating grade implies that the total exposure ceases to be impaired. In stage 3, the credit loss allowances are calculated as lifetime ECL.

Credit loss allowances are calculated individually or collectively. The individual approach is applied in case of exposures to significant defaulted customers and consists of the individual assessment of the difference between the gross carrying amount and the net present value of the expected cash flows which are estimated by workout or risk managers. The discounting of the cash flows is based on the effective interest rate.

A customer is classified as significant if the total on- and off-balance exposure exceeds a predefined materiality limit. Otherwise, the customer is considered as insignificant and a rule-based approach is used for the calculation of the specific allowance. Under this approach, allowances are calculated as the product of gross carrying amount and loss given default (LGD), where LGD depends on characteristics such as time in default or the stage of the workout process.

Collective allowances are calculated for exposures to non-defaulted customers according to a rule-based approach irrespective of the significance of the customer. The level of collective allowances depends on the gross carrying amount, the probability of default, the loss given default and the credit conversion factor in case of off-balance-sheet exposures. The result of discounting future cash flows to their present values is taken into consideration in the LGD calculation.

The risk parameters used in the ECL calculation take into account available information at the reporting date about past events, current conditions and forecasts on future economic trends. Generally, the risk parameters applied in the calculation of collective allowances may differ from the risk parameters compliant to capital requirement regulations if the characteristics of the respective portfolio in combination with IFRS standards necessitate this.

Market Risk

The table below summarizes the VaR values as at 30 June 2018 and 31 December 2017 on the confidence level of 99%. The table shows only the Bank's amounts:

As at 30 June 2018 **in CZK million**	**Total Market Risk**	**Correlation Effect**	**Interest Rate Risk**	**Foreign Currency Risk**	**Equity Risk**	**Volatility Risk**	**Commodity Risk**	**Credit Spread risk**
Trading book								
Daily value	11	–	11	–	–	–	–	–
Monthly value	53	(2)	53	1	1	–	–	–
Average of daily values per year	20	–	20	–	–	–	–	–
Average of monthly values per year	94	(3)	94	1	1	–	1	–
Banking book								
Daily value	272	(60)	247	8	–	–	–	77
Monthly value	1,274	(284)	1,161	35	–	–	–	362
Average of daily values per year	357	(59)	348	5	–	1	–	62
Average of monthly values per year	1,673	(276)	1,630	24	1	5	–	289

As at 31 December 2017 in CZK million	Total Market Risk	Correlation Effect	Interest Rate Risk	Foreign Currency Risk	Equity Risk	Volatility Risk	Commodity Risk	Credit Spread risk
Trading book								
Daily value	10	–	10	–	–	–	–	–
Monthly value	45	(1)	45	–	–	–	–	–
Average of daily values per year	15	(1)	15	1	–	–	–	–
Average of monthly values per year	69	(5)	69	3	1	–	1	–
Banking book								
Daily value	319	(58)	280	5	–	–	–	91
Monthly value	1,494	(272)	1,312	25	1	–	–	427
Average of daily values per year	450	(53)	453	4	–	2	–	44
Average of monthly values per year	2,112	(250)	2,124	19	1	11	–	207

In addition, the Bank uses stress testing or an analysis of impacts of adverse developments in market risk factors on the market value of the trading book and on the parts of the banking book revalued to market values. Scenarios are developed on the basis of historical experience and expert opinions of the Macroeconomic Analyses Department. The stress testing is undertaken on a monthly basis and its results are reported to Financial Markets Risk Management Committee (FMRMC).

Liquidity Risk

The liquidity risk is defined in line with the principles set out by the Basel Committee on Banking Supervision and the CNB. Accordingly, a distinction is made between market liquidity risk, which is the risk that the entity cannot easily offset or close a position at the market price because of inadequate market depth or market disruption, and funding liquidity risk, which is the risk that a credit institution will not be able to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting daily operations and its financial condition.

The Bank reports Liquidity Coverage Ratio („LCR") to the national regulator according to the Delegated Act. Both LCR and Net Stable Funding Ratio ("NSFR") for the Bank have been significantly above 100% for a long time due to good health and high liquidity in the Czech banking system. The Bank also regularly reports Additional Liquidity Monitoring Metrics (ALMM) to the national regulator, which complements already existing Basel III liquidity risk ratios in the form of several detailed liquidity risk reports/measures.

Leverage ratio

The leverage ratio represents the relationship between core capital (tier 1) and the leverage exposure according to Article 429 Capital Requirements Regulation (CRR). Essentially, the leverage exposure represents the sum of unweighted on- and off-balance-sheet positions considering valuation and risk adjustments as defined within the CRR.

As of 30 June 2018, the leverage ratio for the Group at consolidated level amounted to 6.6% (Basel 3 final), comfortably above the 3.0% minimum requirement proposed by the Basel Committee. Tier 1 capital amounted to CZK 99,9 billion at the reference date, while total leverage exposure stood at CZK 1.510,1 billion.

The calculation and disclosure of the leverage ratio are based on the European Commission's delegated regulation ((EU) 2015/62 of 10 October 2014), which was published in the Official Journal of the European Union on 17 January 2015.

37. Fair value of financial instruments

All financial instruments are measured at fair value on recurring basis. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Financial instruments carried at fair value

The measurement of fair value is based primarily on external sources of data (stock market prices or broker quotes in highly liquid market segments). Financial instruments for which the fair value is determined on the basis of quoted market prices are mainly listed securities and derivatives as well as liquid OTC bonds.

Description of valuation models and parameters

The Group uses valuation models that have been tested internally and for which the valuation parameters (such as interest rates, exchange rates, volatilities and credit spreads) have been determined independently. As a consequence of the negative interest environment, shifted Black Scholes valuation model is used for interest rate options for the respective currencies. For this model negative interest rates are no restriction.

Loans. IFRS 9 regulation significantly changed accounting classification of assets. Not SPPI (solely payments of principal and interest) compliant loans are to be valued at fair value. The methodology to compute fair value of these assets corresponds to the basic present value technique where expected cash flows of assets are discounted by the full rate including risk premium required for non-market risk based part of the interest rate to be compliant with fair value

definition. The credit risk is recognized by adjusting contractual cash flows to come to expected cash flows accounting for customer's probability of default and loss given default. These adjusted cash flows are then discounted by effective discount rate incorporating other risk/cost components. The complex interest rate assets are valued by Monte Carlo simulation approach to include convexity correction and time value of embedded options.

Securities. For plain vanilla (fixed and floating) debt securities the fair value is calculated by discounting the future cash-flows using a discounting curve depending on the interest rate for the respective issuance currency and a spread adjustment. The spread adjustment is usually derived from the credit spread curve of the issuer. If no issuer curve is available the spread is derived from a proxy instrument and adjusted for differences in the risk profile of the instruments. If no close proxy is available, the spread adjustment is estimated using other information, including estimation of the credit spread based on internal ratings and PDs or management judgment. For more complex debt securities (e.g. including option-like features such as callable, cap/floor, index-linked) the fair value is determined using combinations of discounted cash flow models and more sophisticated modeling techniques including methods described for OTC-derivatives.

Non-trading equity instruments which have quoted market prices in an active market are valued by using the quoted market price (bid for long position, ask for short position). For other investments in non-trading equity instruments the fair value is determined by standard valuation models using also unobservable input parameters.

OTC-derivative financial instruments. Derivative instruments traded in OTC markets (e.g. interest rate swaps and options, foreign exchange forward and options, options on listed securities and indices) are valued by using standard valuation models. These models include discounting cash flow models, option models of the Black-Scholes. Models are calibrated on quoted market data (including implied volatilities). Valuation models for more complex instruments also use Monte-Carlo-techniques. For instruments in less liquid markets, data obtained from less frequent transactions or extrapolation techniques are used.

The Group values derivatives at mid-market levels. The derivatives position value is adjusted of close-out adjustment to take into account impact of bid/ask spread to the valuation. Parameters are reviewed on a regular basis or in case of significant market moves.

Credit value adjustments (CVA) for counterparty risk and debt value adjustments (DVA) for the own default credit risk are applied to OTC derivatives. For the CVA, the adjustment is driven by the expected positive exposure of all derivatives and the credit quality of the counterparty. DVA is driven by the expected negative exposure and the Group's credit quality. Modelling of the expected exposure is based on option replication strategies for most of the counterparties and the products. For Ministry of Finance of the Czech Republic and for counterparties with Credit Support Annex ('CSA') agreements in place with higher threshold amounts Monte Carlo approach is applied, netting is considered. For CSA counterparties with small threshold amounts no CVA/DVA was taken into account. The methodology for the remaining entities and products is determined by market value plus add-on considerations. The probability of default of counterparties which are not traded in an active market is determined from internal PDs mapped to a basket of liquid titles being present in the central European market. Thereby market based valuation concepts have been incorporated. Counterparties with liquid bond or CDS markets are valued by the respective single-name market based PD derived from the prices.

According to the described methodology the accumulated CVA-adjustments amounted to CZK (106) million and the total DVA-adjustment amounted to CZK 30 million.

Validation and control

The responsibility for valuation of financial instruments measured at fair value is independent from the trading units. In addition, The Group has implemented an independent validation function in order to ensure separation between units responsible for model development, fair value measurement and validation. The aim of independent model validation is to evaluate model risks arising from the models' theoretical foundation, the appropriateness of input data (market data) and model calibration.

Fair value hierarchy

Financial assets and financial liabilities measured at fair value are categorized under the three levels of the IFRS fair value hierarchy.

Level 1 of the fair value hierarchy

The fair value of financial instruments assigned to Level 1 of the fair value hierarchy is determined based on quoted prices in active markets for identical financial assets and liabilities. More particular, the evaluated fair value can qualify as Level 1 if transactions occur with sufficient frequency, volume and pricing consistency on an ongoing basis.

These include exchange traded derivatives (futures, options), shares, government bonds as well as other bonds and funds, which are traded in highly liquid and active markets.

Level 2 of the fair value hierarchy

In case a market quote is used for valuation but due to restricted liquidity the market does not qualify as active (derived from available market liquidity indicators) the instrument is classified as Level 2. If no market prices are available the fair value is measured by using valuation models which are based on observable market data. If all the significant inputs in the valuation model are observable the instrument is classified as Level 2 of the fair value hierarchy. For Level 2 valuations typically yield curves, credit spreads and implied volatilities are used as observable market parameters.

These include OTC derivatives, less liquid shares, bonds and funds as well as own issues.

Level 3 of the fair value hierarchy

In some cases, the fair value can be determined neither on the basis of sufficiently frequent quoted market prices nor on the basis of valuation models that rely entirely on observable market data. In these cases individual valuation parameters which are not observable in the market are estimated on the basis of reasonable assumptions. If any unobservable input in the valuation model is significant or the price quote used is updated infrequently the instrument is classified as Level 3 of the fair value hierarchy. For Level 3 valuations besides observable parameters typically credit spreads derived from internally calculated historical probability of default (PD) and loss given default (LGD) measures are used as unobservable parameters. Furthermore, internally calculated cost of equity and adjustments made on the equity (in the adjusted net asset value method) are unobservable parameters for the valuation of non-trading equity instruments. These include shares, participations and funds not quoted, illiquid bonds as well as loans, own issues and deposits.

Fair value hierarchy

The table below details the methods used to determine the fair value with respect to levels of fair value hierarchy.

	Quoted market prices in active markets Level 1		Marked to model based on observable market data Level 2		Marked to model based on non-observable inputs Level 3		Total	
in CZK million	**Jun 2018**	**Dec 2017**	**Jun 2018**	**Dec 2017**	**Jun 2018**	**Dec 2017**	**Jun 2018**	**Dec 2017**
ASSETS								
Financial assets – held for trading	174	55	11,678	11,273	91	105	11,943	11,433
Derivatives	–	–	11,348	11,196	90	105	11,438	11,301
Other trading assets	174	55	330	77	1	–	505	132
Financial assets designated at fair value through profit or loss	–	12	–	289	–	106	–	407
Non-trading financial assets – FVPL	–	–	281	–	854	–	1,135	–
Equity instruments	–	–	–	–	380	–	380	–
Debt securities	–	–	281	–	407	–	688	–
Loans and advances	–	–	–	–	67	–	67	–
Financial assets – available for sale	–	42,183	–	9,541	–	3,559	–	55,283
Equity instruments	–	–	–	–	–	1,717	–	1,717
Debt securities	–	42,183	–	9,541	–	1,842	–	53,566
Financial assets – FVOCI	40,435	–	7,592	–	4,382	–	52,409	–
Equity instruments	–	–	–	–	1,266	–	1,266	–
Debt securities	40,435	–	7,592	–	3,116	–	51,143	–
Derivatives Hedge Accounting	–	–	184	613	–	–	184	613
Total assets	**40,609**	**42,250**	**19,735**	**21,716**	**5,327**	**3,770**	**65,671**	**67,736**
LIABILITIES								
Financial liabilities held for trading	–	–	11,758	11,405	14	9	11,772	11,414
Derivatives	–	–	11,758	11,405	14	9	11,772	11,414
Other trading liabilities	–	–	–	–	–	–	–	–
Financial liabilities designated at fair value through profit or loss	–	–	1,452	1,240	–	–	1,452	1,240
Deposits from customers	–	–	1,452	1,240	–	–	1,452	1,240
Debt securities issued	–	–	–	–	–	–	–	–
Derivatives Hedge Accounting	–	–	2,731	1,813	–	–	2,731	1,813
Total liabilities	**–**	**–**	**15,941**	**14,458**	**14**	**9**	**15,955**	**14,467**

The allocation of the appropriate level of positions is determined at the end of the reporting period.

Valuation process for financial instruments categorised as Level 3

The valuation of financial instruments categorized as Level 3 involves one or more significant inputs that are not directly observable on the market. Additional price verification steps need to be done. These may include reviewing relevant historical data and benchmarking for similar transactions, among others. This involves estimation and expert judgment.

Changes in volumes of Level 1 and Level 2

This paragraph describes the changes in Volumes of Level 1 and Level 2 of financial instruments measured at fair value in the statement of financial position.

	Jun 2018		Dec 2017	
in CZK million	**Level 1**	**Level 2**	**Level 1**	**Level 2**
Securities				
Net transfer from Level 1	(652)	–	–	–
Net transfer from Level 2	–	(1,650)	–	–
Net transfer from Level 3	–	–	(74)	(1,177)
Purchases/sales/expiries	(989)	(54)	(25,408)	(7,473)
Changes in derivatives	–	(277)	–	(1,010)
Total year-to-date change	**(1,641)**	**(1,981)**	**(25,482)**	**(9,660)**

In the first half of 2018 the relevant unquoted bonds were reclassified from Level 1 to Level 2 due to lower market activity.

The reclassification of securities from Level 1 and from Level 2 to Level 3 was caused by a decrease in market liquidity.

Movements in Level 3 of financial instruments measured at fair value

The following tables show the development of fair value of securities for which valuation models are based on non-observable inputs:

in CZK million	**1 Jan 2018**	**Gain/loss in profit or loss**	**Gain/loss in other comprehensive income**	**Purchases**	**Sales/ Settlements**	**Transfer into Level 3**	**Transfer out of Level 3**	**Currency translation**	**Jun 2018**
ASSETS									
Financial assets – held for trading	105	(84)	–	5	–	65	–	–	91
Derivatives	105	(84)	–	4	–	65	–	–	90
Other trading assets	–	–	–	1	–	–	–	–	1
Non-trading financial assets at fair value through profit or loss	3,015	14	–	67	(2,260)	12	–	6	854
Equity instruments	380	–	–	–	–	–	–	–	380
Debt securities	348	14	–	65	(38)	12	–	6	407
Loans and advances	2,287	–	–	2	(2,222)	–	–	–	67
Financial assets – FVOCI	2,871	–	208	109	–	1,194	–	–	4,382
Equity instruments	1,029	–	237	–	–	–	–	–	1,266
Debt securities	1,842	–	(29)	109	–	1,194	–	–	3,116
Total assets	**5,991**	**(70)**	**208**	**181**	**(2,260)**	**1,271**	**–**	**6**	**5,327**

in CZK million	Dec 2016	Gain/loss in profit or loss	Gain/loss in other compre-hensive income	Purchases	Sales/ Settle-ments	Transfer into Level 3	Transfer out of Level 3	Currency translation	Jun 2017
ASSETS									
Financial assets – held for trading	1,057	(23)	–		(13)		(623)	–	398
Derivatives	1,057	(23)	–		(13)		(623)	–	398
Financial assets designated at fair value through profit or loss	80	(3)	–		–	–	–	(1)	76
Financial assets - available for sale	2,914	–	(147)	915	1	78	–	(23)	3,738
Total assets	**4,051**	**(26)**	**(147)**	**915**	**(12)**	**78**	**(623)**	**(24)**	**4,212**

The gains or losses of Level 3 financial instruments classified as 'Financial assets – held for trading', 'Financial assets – at fair value through profit or loss' (for the period ended 30 June 2017), 'Non-trading financial assets at fair value through profit or loss' (for the period ended 30 June 2018) and 'Hedge accounting derivatives' is disclosed in the income statement line item 'Net trading result'. Gains or losses from derecognition of 'Financial assets – available for sale' is shown in the income statement line item 'Gains/Losses from financial assets and liabilities not measured at fair value through profit or loss, net' for the period ended 30 June 2017. Gains or losses from derecognition of 'Financial assets at fair value through other comprehensive income' is shown in the income statement line item 'Other gains/losses from derecognition of financial instruments not measured at fair value through profit or loss' for the period ended 30 June 2018. Impairments of 'Financial assets – available for sale' are disclosed in the line item 'Net impairment loss on financial assets' for the period ended 30 June 2017. Impairment of 'Financial assets at fair value through other comprehensive income' is disclosed in the line item 'Impairment result from financial instruments' for the period ended 30 June 2018. Gains or losses in other comprehensive income of Level 3 financial instruments disclosed in the balance sheet line item 'Financial assets – available for sale' are reported directly in equity under 'Available for sale reserve' for the period ended 30 June 2017. Level 3 gains or losses in other comprehensive income disclosed in the balance sheet line item 'Financial assets at fair value through other comprehensive income' are reported directly in equity under 'Change in fair value reserve' for the period ended 30 June 2018.

Level 3 movements. The reclassification of securities to Level 3 was caused by a decrease in market liquidity.

Gains or losses on Level 3 instruments held at the reporting period's end and which are included in profit or loss are as follow:

in CZK million	1–6 2018 Unrealized gain/loss in profit or loss	1–6 2017 Unrealized gain/loss in profit or loss
ASSETS		
Financial assets – held for trading	(84)	(23)
Derivatives	(84)	(23)
Financial assets designated at fair value through profit or loss	–	(3)
Non-trading financial assets at fair value through profit or loss	67	–
Debt securities	67	–
Financial assets at fair value through other comprehensive income	(5)	–
Debt securities	(5)	–
Total	**(22)**	**(26)**

Sensitivity analysis for Level 3 measurements

The following table shows the sensitivity analysis using reasonably possible alternatives per product type:

	Positive fair value changes when applying alternative valuation parameters		Negative fair value changes when applying alternative valuation parameters	
in CZK million	**Jun 2018**	**Dec 2017**	**Jun 2018**	**Dec 2017**
Derivatives	9	9	(7)	(8)
Income statement	9	9	(7)	(8)
Debt securities	75	65	(99)	(87)
Other comprehensive income	75	65	(99)	(87)
Equity instruments	98	64	(197)	(129)
Income statement	35	–	(70)	(1)
Other comprehensive income	63	64	(127)	(128)
Total	**182**	**138**	**(303)**	**(224)**
Income statement	**44**	**9**	**(77)**	**(9)**
Other comprehensive income	**138**	**129**	**(226)**	**(215)**

In estimating these impacts, mainly changes in credit spreads (for bonds), PDs, LGDs (for CVA of derivatives) and market values of comparable equities were considered. An increase (decrease) of spreads, PDs and LGDs result in a decrease (increase) of the corresponding market values.

Following ranges of reasonably possible alternatives of the unobservable inputs were considered in the sensitivity analysis table:

- for debt securities range of credit spreads between +100 basis points and –75 basis points,
- for equity related instruments the price range between –10% and +5%,
- for CVA on derivatives PDs rating upgrade/downgrade by one notch, the range for LGD between –5% and +10%.

Financial instruments not carried at fair value with fair value disclosed in the notes

The following table shows fair values and fair value hierarchy of financial instruments whose fair value is disclosed in the notes for the 30 June 2018 and for the year-end 2017.

Jun 2018 **in CZK million**	**Carrying amount**	**Fair value**	**Quoted market prices in active markets Level 1**	**Marked to model based on observable market data Level 2**	**Marked to model based on non-observable inputs Level 3**
ASSETS					
Cash and cash balances	139,810	139,810	–	–	–
Financial assets at amortised costs	1,202,797	1,196,808	176,704	13,141	1,006,963
Loans and advances to banks	320,701	321,024	–	–	321,024
Loans and advances to customers	696,051	684,873	–	–	684,873
Debt securities	186,045	190,911	176,704	13,141	1,066
Finance lease receivables	2,066	2,066	–	–	2,066
Trade and other receivables	128	128	–	–	128
LIABILITIES					
Financial liabilities measured at amortised costs	1,288,615	1,290,175	–	459	1,289,716
Deposits from banks	367,762	371,362	–	–	371,362
Deposits from customers	918,266	916,218	–	–	916,218
Debt securities issued	935	943	–	459	484
Other financial liabilities	1,652	1,652	–	–	1,652
FINANCIAL GUARANTEES AND COMMITMENTS					
Financial guarantees	n/a	399	–	–	399
Irrevocable commitments	n/a	(460)	–	–	(460)

n/a ....not applicable

December 2017 in CZK million	Carrying amount	Fair value	Quoted market prices in active markets Level 1	Marked to model based on observable market data Level 2	Marked to model based on non-observable inputs Level 3
ASSETS					
Cash and cash balances	280,221	280,221	–	–	–
Financial assets - held to maturity	163,679	189,419	159,613	29,806	–
Loans and receivables to credit institutions	157,525	157,924	–	1,874	156,050
Loans and receivables to customers	638,694	636,784	–	–	636,784
LIABILITIES					
Financial liabilities measured at amortised costs	1,179,929	1,192,947	–	16,113	1,176,834
Deposits from banks	295,232	295,008	–	–	295,008
Deposits from customers	881,997	880,032	–	–	880,032
Debt securities issued	1,805	17,012	–	16,113	899
Other financial liabilities	895	895	–	–	895
FINANCIAL GUARANTEES AND COMMITMENTS					
Financial guarantees	n/a	5	–	–	5
Irrevocable commitments	n/a	275	–	–	275

n/a ....not applicable

In the table above, positive fair values of financial guarantees and commitments are shown with a positive sign whereas negative fair values are shown with a negative sign.

The fair value of loans and advances to customers and credit institutions has been calculated by discounting future cash flows while taking into consideration interest and credit spread effects. The interest rate impact is based on the movements of market rates, while credit spread changes are derived from PDs and LGDs used for internal risk calculations. For the calculation of fair value loans and advances were grouped into homogeneous portfolios based on rating method, rating grade, maturity and the country where they were granted.

The fair values of financial assets at amortised cost are either taken directly from the market or they are determined by directly observable input parameters (i.e. yield curves).

The fair value of deposits and other liabilities, measured at amortised cost, is estimated by taking into account the current interest rate environment, as well as the own credit spreads. These positions are assigned to the Level 3 category. For liabilities without contractual maturities (e.g. demand deposits), the carrying amount represents the minimum of their fair value.

The fair value of issued securities and subordinated liabilities measured at amortized cost is based on market prices or on observable market parameters, if these are available. For issued securities where the fair value cannot be retrieved from quoted market prices, the fair value is calculated by discounting the future cash flows.

38. Contingent assets and liabilities

in CZK million	Jun 2018	Dec 2017
Amounts owed under guarantees and letters of credit	22,491	19,461
Undrawn loan commitments	124,635	115,052
Total	**147,126**	**134,513**

Contingent liabilities – litigations

There have not been any material changes since year-end 2017 in the assessment of the influence of the outcome of the litigation cases in which Česká spořitelna, a.s. and some of its subsidiaries are involved with respect of the financial and/or earnings situation of the Group.

39. Events after the balance sheet date

There are no significant events after the balance sheet date.

Definitions of Alternative Performance Indicators

In line with the General Directive issued by ESMA (European Securities and Markets Authority) are Alternative Performance Indicators defined as financial indicators of historical or future financial performance, financial position or cash flow.

Alternative Performance Indicators that can be determined directly from the consolidated financial statement

Alternative Performance Indicator		Financial statement
Net interest income	A	Consolidated income statement
Net fee and commission income	B	Consolidated income statement
Dividend income	C	Consolidated income statement
Net trading result	D	Consolidated income statement
Gains/losses from financial assets and liabilities measured at fair value through profit or loss	E	Consolidated income statement
Net result from equity method investments	F	Consolidated income statement
Rental income from investment properties and other operating leases	G	Consolidated income statement
Operating income	**H=A+B+C+D+E+F+G**	**Consolidated income statement**
Personnel expenses	I	Consolidated income statement
Other administrative expenses	J	Consolidated income statement
Depreciation and amortisation	K	Consolidated income statement
Operating expenses	**L=I+J+K**	**Consolidated income statement**
Operating result	**H+L**	**Consolidated income statement**
Cost/Income ratio	**−L/H**	**Consolidated income statement**
Non-interest income/Operating income	**(B+C+D+E+F+G)/H**	**Consolidated income statement**
Non-trading financial assets at fair value through profit or loss – loans and advances to customers	M	Consolidated statement of financial position
Financial assets at amortised costs – loans and advances to customers	N	Consolidated statement of financial position
Financial assets at fair value through other comprehensive income – loans and advances to customers	O	Consolidated statement of financial position
Finance lease receivables	P	Consolidated statement of financial position
Trade and other receivables	Q	Consolidated statement of financial position
Financial liabilities at fair value through profit or loss – deposits from customers	R	Consolidated statement of financial position
Financial liabilities at amortised cost – deposits from customers	S	Consolidated statement of financial position
Finance lease liabilities to customers	T	Consolidated statement of financial position
Loans to customers/deposits from customers	**U=(M+N+O+P+Q)/(R+S+T)**	**Consolidated statement of financial position**

The purpose of the Alternative Performance Indicators:

Operating income shows the amount of bank revenues from core business activities.

Operating expenses express the volume of bank costs used for core business activities.

Operating result gives information about the success rate of core business activity. It shows the amount of financial resources that was earned from core business activity.

Cost/income ratio – this indicator expresses the volume of operating expenses consumed to achieve the operating income. The ratio gives a clear view of how efficiently the bank is being run – the lower it is, the more profitable the bank is.

Non-interest income/Operating income – the indicator shows the share of revenues different from interest income on total income from core business activity.

Loans to customers/deposits from customers – the indicator shows the share of customer deposits used for funding of customer loans.

Alternative Performance Indicators that cannot be determined directly from the consolidated financial statement:

ROA

The ROA (Return on Assets) indicator shows how efficient bank's management is at using its assets to generate earnings. It is calculated as a ratio of consolidated net profit in the accounting period attributable to the owners of the parent company (Consolidated income statement) to the average monthly volume of total assets (internal figure for 13 periods – calculates with balances as of 1 January of the corresponding year and the last days of all months of the corresponding year).

ROE

The ROE (Return on Equity) indicator measures the efficiency of equity utilization, and its final value expresses the share of the net profit attributed to one Czech Crown of the equity. It is calculated as a ratio of the consolidated net profit in the accounting period attributable to the owners of the parent company (Consolidated income statement) to the average monthly volume of equity attributable to the owners of the parent (internal figure for 13 periods – calculates with balances as of 1 January of the corresponding year and the last days of all months of the corresponding year).

Net Interest Margin

Česká spořitelna uses the indicator as the representation of interest-bearing asset profitability. It is calculated as a ratio where the numerator is the sum of the consolidated Net Interest Income, Dividend Income, and Rental income from investment properties and other operating leases decreased by the depreciation of these properties (Consolidated income statement), and the denominator is the average monthly volume (internal figure for 13 periods – calculates with balances as of 1 January of the corresponding year and the last days of all months of the corresponding year) of the sum of Non-trading financial assets at fair value through profit or loss, Financial assets at fair value through profit or loss, Financial assets – available for sale, Financial assets – held to maturity, Financial assets at fair value through other comprehensive income, Financial assets at amortised costs, Loans and receivables to credit institutions, Loans and receivables to customers, Finance lease receivables to customers, Investments in associates and Investment properties.

Ratio of defaulting receivables from clients to total volume of receivables from clients

The indicator is the basic indicator of the quality of bank loan portfolio. It is calculated as a ratio of consolidated gross loans and advances to defaulting customers to consolidated gross loans and advances to customers.

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