ČESKOMORAVSKÁ ZÁRUČNÍ A ROZVOJOVÁ BANKA, a. s.

2016

annual review

The aim of the bank is to contribute and participate in promoting economic and social development of the Czech Republic through the provision of advantaged financial products, especially in the areas of small and medium-sized enterprises, infrastructure development and in other sectors of the economy.

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Chairman's introduction

The year 2016 was crucial for Českomoravská záruční a rozvojová banka, a.s. (CMZRB), because it clearly directed the Bank's future development. The government decided to prepare a project of CMZRB transition into a national development bank, thus confirming the growing importance of financial instruments in implementing the state's economic policy measures. Having boosted its share capital by half a billion Czech crowns, the Bank can now begin to work on extending its range of activities. This is not only to help small and medium-sized enterprises, but in favour of other areas, where it can provide assistance in the form of guarantees and preferential loans requiring exposure of the Bank's capital.

Continuing growth of the Czech economy occurred once again in an environment of low interest rates, which strengthened the appeal among small and medium-sized enterprises and banks for CMZRB bank guarantees. In 2015, CMZRB joined the COSME guarantee programme using resources from the European Fund for Strategic Investments, through which the European Commission intends to stimulate investment activity within the EU. The agreed financial framework was quickly exhausted due to the strong demand for guarantees in the second half of 2016.Therefore, CMZRB increased the capacity of the GUARANTEE 2015-2023 Programme thanks to a counter-guarantee from the European Investment Fund. The Bank will thus be able to guarantee another CZK 10 billion in loans to small entrepreneurs and to triple the number of supported projects by the end of 2018.

In the past year, CMZRB also advanced preparations for implementing new financial instruments. Many rounds of negotiations with the Ministry of Industry and Trade took place, the result of which will be launching of the ENERG and EXPANZE programmes. The former should contribute to reducing energy consumption and boosting the use of renewable sources of energy in small and medium-sized enterprises in Prague, and the latter will provide support for small and medium-sized enterprises within the Operational Programme Enterprise and Innovations for Competitiveness.

The Bank continued to carefully manage risks in 2016 and steadfastly achieved its targets for key indicators at levels confirming the Bank's stability and trustworthiness. Despite reduced income resulting from continuing changes in the yield structure of its transactions and persistent low interest rates, the Bank succeeded to boost its participation in co-financing new national guarantee programme.

Last year, the Bank continued its active involvement in European networks of development and guarantee institutions. CMZRB participated in work meetings of ELTI, AECM and NEFI associations. In the letter case CMZRB hosted a two-day meeting aimed at sharing experiences in preparing instruments financed from European structural and investment funds.

The Bank will meet the challenges for the coming years in compliance with the rules of the European Commission defining the principles of operation for national promotional banks and with the instructions of the Czech government. Co-operation with partners, other than ministries exercising the state's shareholder rights within the Bank, will also comprise a part of this effort. The Bank's main business objective in 2017 will be its involvement in the administration of financial instruments within structural funds for the Ministry of Industry and Trade.

I would like to thank all of the Bank's employees for their great dedication and energy that they invested into working at CMZRB during such a transformative year. It is to their credit that we achieved excellent results in supporting small and medium-sized enterprises and I am thus able to declare the past year a success. I also appreciate the efforts of the shareholder's representatives towards launching the process of CMZRB transformation into a national development bank, reinforcing the Bank's capital, and expanding the scope of its activities. I firmly believe that through our joint efforts we will adopt additional measures in 2017 that will accelerate the transition process of the Bank, and contribute to broadening its offer with programmes and products supporting economic growth and competitiveness of businesses within the market.

Jiří Jirásek
Chairman of the Board of Directors

The Government of the Czech Republic adopted a resolution on 23 October 1991 for the founding of a specialised banking institution to support small and medium-sized enterprises. This institution was entered into the Commercial Register in January 1992 under the name Českomoravská záruční a rozvojová banka, a.s. (hereinafter referred to as "CMZRB" or the "Bank").

The Bank's initial scope of business was directed solely to implementing government programmes for the support of small and medium-sized enterprises. In subsequent years, that activity was extended to include providing support in the areas of housing and financing infrastructure development projects. CMZRB has a full banking licence, a foreign exchange licence, as well as a securities broker's licence issued under the relevant laws.

At present, CMZRB's main mission as a fully state-owned institution is to facilitate primarily small and medium-sized enterprises' access to financing through specialised banking products and, in accordance with the economic policy aims of the government and regions of the Czech Republic, to assist in developing other selected areas of the economy requiring public support.

Throughout its entire time in operation, the Bank has co-operated closely with ministries, state funds, regions, banks, economic chambers and other business representatives. Co-operation with European entities and partner institutions abroad has also become more important in recent years.

The specific character of CMZRB's activities, the development of modern banking and communication technologies, and its traditionally good co-operation with partners enable the Bank to provide its clients with high-quality banking services all across the Czech Republic while having positive effects on those clients' development. Clients may use the services of the Bank's branches in Prague and in the regional centres of Brno, Hradec Králové, Ostrava and Pilsen. The Bank operates a regional office in České Budějovice for even better contact with its clients.

BANK'S OFFICES

Branch
Regional office

CMZRB offers its clients bank guarantees, preferential loans, financial subsidies and related banking services. It manages an extensive portfolio of guarantees and grants provided for apartment block repair. Financing projects to improve the technical condition of infrastructure and the development of municipalities also constitute part of the Bank's activities. CMZRB additionally uses resources from international financial institutions for these purposes.

The two most important client groups are small and medium-sized enterprises and the owners of apartment blocks, in particular housing co-operatives and apartment-owners associations. Other users of the Bank's services include municipalities, regional authorities, ministries and state funds.

Selected economic indicators

	Unit	2012	2013	2014	2015	2016
Total assets	CZK mil.	111,706	98,042	127,337	30,999	27,612
Liabilities	CZK mil.	106,748	93,591	122,642	26,124	22,253
Shareholder's equity	CZK mil.	4,958	4,451	4,695	4,875	5,359
Share capital	CZK mil.	2,132	2,132	2,132	2,132	2,632
Profit after tax	CZK mil.	812	348	262	196	28
Guarantee portfolio	CZK mil.	19,039	18,129	17,900	19,926	18,922
Capital ratio	%	14.4	16.0	17.1	18.5	19.9
Average number of employees	-	217	216	211	209	209
Branches	-	5	5	5	5	5

The Bank's shareholder holding all voting rights is the Czech Republic, represented by the Ministry of Industry and Trade, Ministry of Regional Development, and Ministry of Finance.

CMZRB conducts no research and development activities.

The Bank's activities have no negative environmental impacts.

It systematically develops employees' knowledge and skills, applies proven rules for motivating and rewarding employees, and operates a social programme.

CMZRB has no foreign branches or subsidiaries.

In 2016, CMZRB did not acquire any of its own shares or ownership interests.

Board of Directors

Chairman	Jiří Jirásek
Vice-Chairman	Pavel Weiss until 31 December 2016
Members	Lubomír Rajdl until 31 December 2016
	Jan Ulip until 31 March 2016
	Ivan Duda as from 1 April 2016
	Ivo Škrabal as from 1 April 2016

Supervisory Board

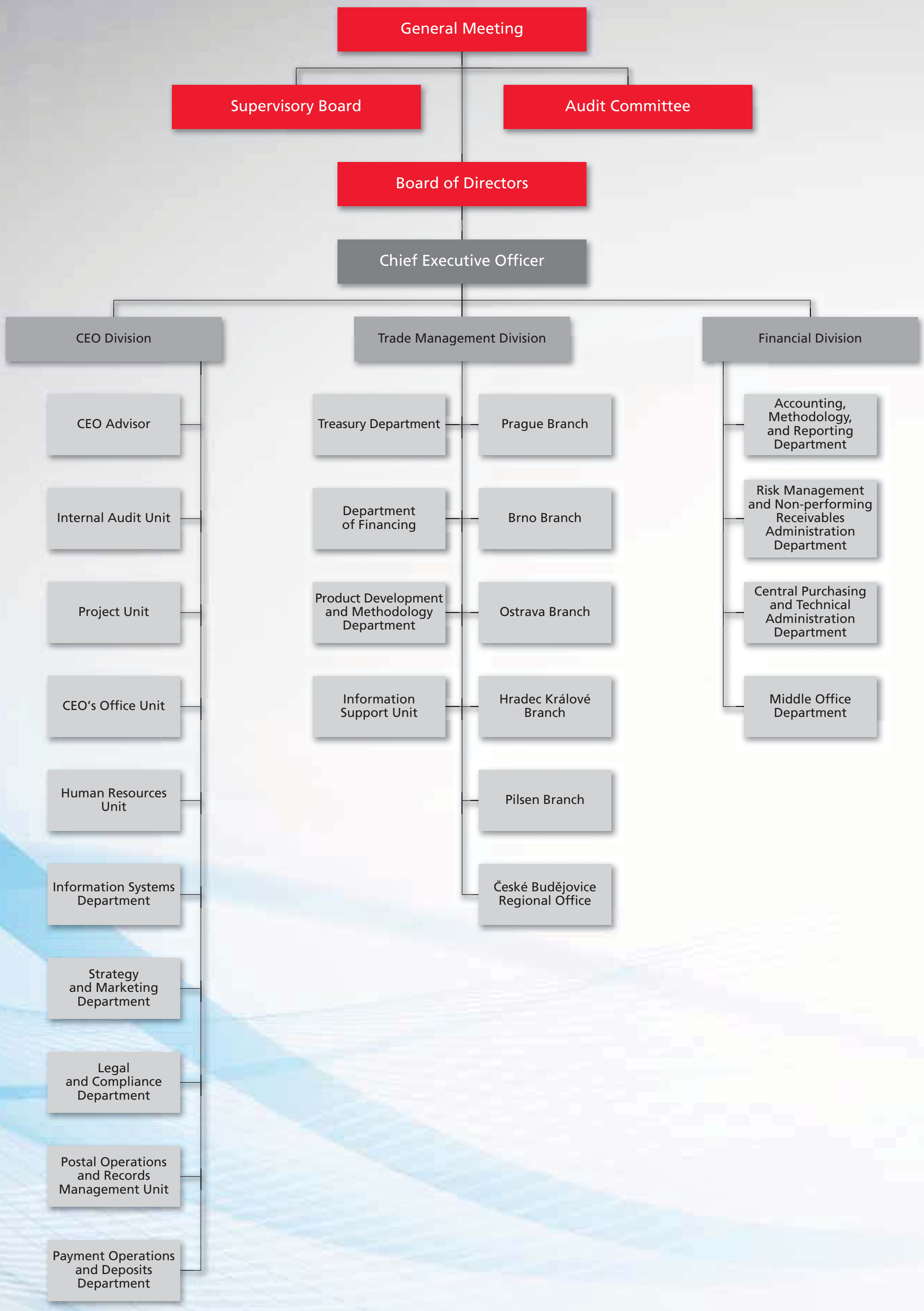
Chairman	Robert Szurman
Vice-Chairman	Pavel Kysilka, member as from 26 April 2016, Vice-Chairman as from 7 June 2016, membership and function terminated 13 December 2016
Members	Lenka Dupáková as from 26 April 2016
	Ladislav Koděra
	Marie Kotrlá
	Olga Letáčková
	Zdeněk Mareš
	Tomáš Novotný
	Jana Šindelářová

As of 26 April 2016 Jan Gregor ended his membership in the Supervisory Board.

Audit Committee

Chairman	Milan Novák
Vice-Chairman	Josef Doruška
Member	Robert Szurman

Organisation chart



(Organisation chart valid as from 1 January 2017)

The data disclosed up to page 35 of this Annual Review have been derived from the financial statements of Českomoravská záruční a rozvojová banka, a.s., as at 31 December 2016 and for the year then ended prepared in accordance with Czech accounting legislation (“Statutory financial statements”). The full version of the Statutory financial statements is included in the Annual Report of Českomoravská záruční a rozvojová banka, a.s., which is published on www.cmzrb.cz in the original Czech language.

The financial statements of Českomoravská záruční a rozvojová banka, a.s., in this Annual Review are prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

Českomoravská záruční a rozvojová banka, a.s., declares that as of the date of processing the annual review no negative changes in the financial situation or any other changes had occurred that would influence the accurate and correct assessment as to the financial position of Českomoravská záruční a rozvojová banka, a.s.

Report of the Board of Directors on the Bank's business activities and financial situation for the 2016 financial year

2016

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Economic growth in the Czech Republic slowed down during 2016 in comparison to 2015. The Czech economy was nevertheless among the strongest developing within the EU. The unemployment rate was only 5.2%, ranking the Czech Republic first within the EU by that indicator. Most sectors of the national economy, and in particular manufacturing, contributed to the positive economic development, and enterprises' investment activity also picked up. Positive expectations and rising wages brought growth in household consumption. Exporters' incomes were positively affected by the Czech crown's stable exchange rate maintained above 27 CZK/EUR through the Czech National Bank's interventions. This generally favourable picture was brightened further by the report of a CZK 61.8 billion positive state budget balance for 2016. Since the founding of the independent Czech Republic, a positive balance has been achieved only during 1993-1995 but never as much as the amount of last year.

Similarly as in the preceding year, banking institutions' activities were influenced in 2016 by an environment of low interest rates along with a continuing surplus of liquidity. At the end of 2016, the two-week repo interest rate remained at the same level as in 2015 (i.e. at 0.05%). A persistent phenomenon facing banks and other investors consisted in negative interest rates on investments into Czech government bonds. At the end of 2016, government bonds with 1- and 2-year maturities were traded with rates of around –1%.

Expansion in newly issued loans also affected the small and medium-sized enterprises sector. In the environment of very low interest rates limiting risk premiums, the low interest rates put pressure on the size and quality of security for business loans. Continued interest in CMZRB guarantees was a natural result of such circumstances. Due to the strong demand for guarantees in the second half of 2016, the agreed financial framework was quickly exhausted and CMZRB was thus forced to seek additional sources for financing guarantees sooner than originally anticipated. The active and accommodating approach on the part of the European Investment Fund (EIF) and the Ministry of Industry and Trade enabled the acquisition of additional needed funds, and the guarantee programme was therefore able to continue without interruption. Through its participation in Juncker's Investment Plan for Europe, the Bank will thus be able to guarantee loans to small entrepreneurs totalling CZK 15 billion through the end of 2018.

In the European context, 2016 was marked by efforts of the European Commission and the European Central Bank (ECB) to sustain the jump-started economic growth recorded in a majority of EU member states. After exhausting all possibilities to support economic growth through low interest rates, ECB shifted to a policy of quantitative easing with the objective of stimulating credit activity and averting deflation. The European Commission continued its ambitious Investment Plan for Europe with the objective of stimulating investment activities in the EU. In the second half of 2016, it even announced an increase in the capacity of Juncker's package in order to support double the number of projects in a minimum amount of EUR 500 billion.

The use of European Structural and Investment (ESI) funds during the 2014-2020 programming period assumes a substantial increase in support provided through financial instruments in the forms of loans, guarantees and risk capital. The amount of funds anticipated for these new forms of support, however, will be less than originally and optimistically expected. These instruments should already have been actively in use within the Czech Republic during 2016. Unfortunately, such expectations went unmet. In all operational programmes, preparatory activities were focused on establishing financing models in the form of financial instruments and conditions both for intermediaries and for final recipients, as well as examining the feasibility of their centralised administration in the Czech Republic.

Several calls for grant applications were announced in 2016 despite a number of problems. Unfortunately, some of these grant calls are directed to areas where financial instruments could have been utilised, and that adversely affected the possibilities for their expansion and speedy implementation.

The shift in negotiations between the Bank and the Ministry of Industry and Trade that occurred especially in the second half of 2016 was of crucial importance for the Bank's work as financial instruments administrator within the Operational Programme Enterprise and Innovations for Competitiveness. Negotiations concerning the relevant agreements were nearing conclusion at the end of the year, and it is highly probable that the EXPANZE Programme will be launched at the turn of the first and second quarters of 2017. The guarantees and preferential loans to be provided under the EXPANZE Programme will enable many small and medium-sized enterprises more easily and under more favourable conditions to acquire bank loans for starting or developing their businesses. Moreover, a support programme focused on energy savings (the ENERG Programme), which the government approved at the start of November 2016, provides the Bank with the possibility to offer enterprises co-financing of energy savings projects in the form of preferential loans combined with interest rate subsidies as well as subventions on energy audit expenses in 2017.

Changes and incentives from the external environment have added to the difficulty of the conditions under which the Bank will operate. As true for the banking sector as a whole, CMZRB in coming years will face increased financial burdens from measures to enhance transparency of the provided support, Europe-wide measures related to curbing tax evasion, requirements under EU regulations for the European Fund for Strategic Investments (EFSI) and ESI funds, and a number of other new obligations require additional costs to CMZRB to ensure their implementation.

The Bank's capital was increased by CZK 500 million at the end of 2016. This step improves the initial conditions for implementing the project to transform CMZRB into a national development bank. Its preparation was decided by the government in October 2016. The project will include the drafting of a substantive proposal for an act on a national development bank as an important instrument for implementing the government's economic policy using financial instruments.

On 17 October 2016, the Government of the Czech Republic approved the "Activation of CMZRB" document presented by the Minister of Industry and Trade. The document highlighted the need to establish a national financial development institution into which Českomoravská záruční a rozvojová banka, a.s., will begin to be transformed on the basis of the project currently being prepared. The document also anticipates the preparation of a substantive proposal for an act on a national development bank.

The approved document instructed the Minister of Industry and Trade in co-operation with the First Deputy Prime Minister and the Minister of Finance, Minister of Regional Development, and Deputy Prime Minister for the Science, Research and Innovation to ensure elaboration of the project for transforming Českomoravská záruční a rozvojová banka, a.s., into a national development bank and to submit it to the government for approval in 2017.

The project is to be implemented in accordance with the basic project document prepared in compliance with project management standards and strategically managed by a steering committee comprised of representatives of ministries involved in its preparation, predominantly deputy ministers and a CMZRB representative. The Ministry of Agriculture is considering how to use CMZRB to support small and medium non-agricultural enterprises in rural areas, and thus it, too, is involved in the project preparation at all levels. The project team has a similar composition. Its members, mostly directors of professionally pertinent departments of ministries and CMZRB, ensure the processing of project outputs. Organisational and co-ordination support for the project implementation is provided by CMZRB, whose budget also provides financing for potential external costs connected to project preparation.

The project's objective has been outlined as follows:

- Define a model for CMZRB's operation as a national development bank (hereinafter referred to as "NDB");
- Define measures leading to its implementation inside and outside the Bank in the form of an implementation plan for transforming CMZRB into NDB.

Project implementation will take place in two stages.

The following areas will be addressed in the first stage:

- Analysis of the main features of NDB operations in EU countries;
- Procurement method and position of NDB as a contracting authority;
- Position of NDB with regard to state aid;
- Contributions to financial instrument from European and national resources;
- Principles of financial management and relationship with programme initiators, including relationship with the state treasury;
- Statistical classification of NDB and impact on the state debt;
- Bank's bodies and shareholder's representatives – proposals for changes;
- Product strategy – basic product types;
- Fundraising for NDB operations and need for state guarantee;
- Areas of supported projects;
- Principles of the substantive proposal for the NDB act.

The second stage will concentrate on proposing an implementation plan for the measures of CMZRB's transformation, connecting the project with work outputs from the National Investment Strategy, and proposing principles of the substantive proposal for the NDB act as the main parts of the document for the Government of the Czech Republic, including its discussion in an inter-departmental comments procedure.

Another integral part of the transformation process was the CZK 500 million increase in the Bank's capital. This was approved by the General Meeting of Českomoravská záruční rozvojová banka, a.s., in November 2016. The Bank's share capital is now CZK 2,632 million. The shares of individual ministries in the Bank's capital remained unchanged after the increase. This increase in capital will enable the Bank to extend its range of activities performed on the basis of the mandate from Czech institutions.

The Bank’s articles of association were also changed at the end of 2016. In particular, the number of Board members was reduced from five to three (effective as from 1 January 2017) and the competencies of the General Meeting were modified. These changes also necessitated changes in the Bank’s organisational structure and its governing processes.

Basic economic characteristics of the Bank for 2012–2016

	Unit	2012	2013	2014	2015	2016
Total balance sheet	CZK mil.	111,706	98,042	127,337	30,999	27,612
Assets:						
Deposits and loans at banks	CZK,mil.	70,045	63,884	91,060	261	86
Securities accepted by the Czech National Bank for refinancing	CZK,mil.	18,545	7,783	9,946	10,474	16,195
Debt securities	CZK,mil.	5,513	11,272	13,929	10,703	4, 308
Payments from guarantees and other classified receivables	CZK,mil.	4,479	3,556	3,082	2,477	1,942
Liabilities and equity:						
Shareholder's equity	CZK,mil.	4,958	4,451	4,695	4,875	5,359
Liabilities	CZK,mil.	106,748	93,591	122,642	26,124	22,253
of which: reserves	CZK,mil.	2,342	2,495	2,909	3,124	3,165
funds to cover credit risks	CZK,mil.	2,680	2,557	2,341	2,659	2,011
Off-balance sheet:						
Guarantees granted	CZK,mil.	19,039	18,129	17,900	19,926	18,922
Total revenues	CZK mil.	4,410	3,505	2,969	2,785	2,453
of which: from securities and interbank operations	CZK,mil.	725	516	426	376	319
from operations with clients	CZK,mil.	976	686	568	454	329
Total expenses	CZK mil.	3,599	3,157	2,707	2,589	2,425
of which: net impairment allowances and provisions	CZK,mil.	225	442	382	331	102
Profit after tax	CZK mil.	812	348	262	196	28
Capital ratio	%	14.4	16.0	17.1	18.5	19.9

The volume of newly concluded transactions in 2016 was CZK 9 billion (in 2015: CZK 11.1 billion). The transactions were financed from the Bank's own resources and those of the programme's contracting authority (Ministry of Industry and Trade) for financing the costs of preferential guarantees in programmes supporting small and medium-sized enterprises. The total value of the guarantee and loan transaction portfolios decreased by 7.5% to CZK 21 billion, with the guarantee transaction portfolio declining by 5% year on year to CZK 18.9 billion.

The slide in income from business activities continued in 2016, due in particular to changes in the Bank's pricing policy (since the second half of 2012, the prices of newly provided loans and guarantees have not included profit) and the continuing drop in income from the bond market. Due to the shareholder's decision to use the maximum amount of the Bank's operating income to support new transactions and cover their risks at the expense of net profit, the Bank recorded a profit after tax of CZK 28 million, which was CZK 168 million lower than in 2015. There was a year-on-year gain in shareholder's equity from CZK 4.9 billion to CZK 5.4 billion arising especially from an increase in share capital by CZK 500 million. The capital ratio stood at 19.9% as of 31 December 2016, which is 1.4 percentage points higher than at the close of the previous year.

Credit risk continued to constitute the most significant type of risk impacting the Bank, and 91.4% of capital dedicated to risk coverage related to this type of risk. As of the end of 2016, all expected credit risk losses were fully covered by impairment allowances and provisions in an amount corresponding to Czech and international standards, and the total balance of impairment allowances and provisions for credit risk was CZK 5 billion (i.e. 23.6% of the value of the guarantee and loan portfolio). Credit risks for certain types of guarantee products were covered by funds for credit risks provided by the programme originators in a total value of CZK 2 billion. As of the end of the year, moreover, the Bank had at its disposal reserve funds in shareholder's equity of CZK 1.34 billion.

The overall balance sheet at the end of 2016 decreased by 10.9% to CZK 27.6 billion. In particular, liabilities due to state institutions diminished (–CZK 3 billion). On the assets side, there were in particular lower amounts due from clients (–CZK 2.4 billion) and values of bonds (–CZK 0.6 billion). The balance sheet total does not include bank guarantees issued for loans to small and medium-sized enterprises and which comprise a significant part of the Bank's business activities and credit exposure. Their value was CZK 18.9 billion as of the end of 2016.

On the assets side, the Bank had at its disposal a portfolio of financial investments amounting to CZK 20.6 billion (74.6% of net assets) and placed predominantly as state bonds and bonds of selected banks and companies (74.3% of net assets). Important net asset items reported in loans and advances to customers were loans provided to state institutions (15.5% of net assets) and loans to other clients (8.7% of net assets). Non-earning assets comprised 1.2% of the total balance sheet.

The funding sources on the liabilities and equity side were provided primarily by amounts due to customers (40.8% of liabilities and equity) and banks (24.8% of liabilities and equity), shareholder's equity (19.4% of liabilities and equity), provisions (11.5% of liabilities and equity), as well as temporary and other liabilities.

Determination of capital ratio and other additional indicators

Indikator	Unit	2012	2013	2014	2015	2016
Tier 1 (T1) capital	CZK '000	**3,775,768**	**3,876,104**	**3,867,425**	**4,012,794**	**4,516,436**
Common equity tier 1 (CET1) capital	CZK '000	**3,775,768**	**3,876,104**	**3,867,425**	**4,012,794**	**4,516,436**
Instruments eligible for CET1 capital	CZK '000	**237,810**	**237,810**	**1,355,628**	**2,131,550**	**2,631,626**
Paid-in CET1 instruments	CZK '000	2,131,550	2,131,550	2,131,550	2,131,550	2,631,626
Acquired own CET1 instruments	CZK '000	**-1,893,740**	**-1,893,740**	**-775,922**	**0**	**0**
Own CET1 instruments acquired directly	CZK '000	-1,893,740	-1,893,740	-775,922	0	0
Retained earnings/accumulated losses	CZK '000	**2,414,171**	**2,519,209**	**1,413,018**	**756,011**	**756,011**
Retained earnings/accumulated losses from previous years	CZK '000	2,414,171	2,519,209	1,413,018	756,011	756,011
Accumulated other comprehensive income	CZK '000	0	0	514,099	640,738	0
Other reserve funds	CZK '000	1,150,000	1,150,000	1,150,000	1,150,000	1,150,000
Adjustments to CET1 capital from use of prudential filters	CZK '000	0	0	-18,546	-1,425	-732
Value adjustments pursuant to prudential revaluation requirements	CZK '000	0	0	-18,546	-1,425	-732
Other intangible assets	CZK '000	**-26,213**	**-30,915**	**-32,675**	**-23,342**	**-20,469**
Other intangible assets – gross value	CZK '000	-26,213	-30,915	-32,675	-23,342	-20,469
Other transitional adjustments to CET1 capital	CZK '000	0	0	-514,099	-640,738	0
Tier 2 (T2) capital	CZK '000	0	0	0	0	0
Capital	CZK '000	**3,775,768**	**3,876,104**	**3,867,425**	**4,012,794**	**4,516,436**
Total risk exposure	CZK '000	**26,221,834**	**24,183,705**	**22,563,626**	**21,734,647**	**22,666,565**
Total risk-weighted exposure relating to credit risk pursuant to the Standardised Approach	CZK '000	20,432,320	20,526,097	18,765,897	18,830,208	20,583,545
Exposures to central governments and banks	CZK '000	182,699	89,147	31,084	0	0
Exposures to regional governments and local bodies	CZK '000	349,186	355,538	205,584	194,933	168,033
Exposures to public sector entities	CZK '000	0	0	0	0	0
Exposures to international development banks	CZK '000	0	0	0	0	0
Exposures to international organisations	CZK '000	0	0	0	0	0
Exposures to institutions	CZK '000	1,282,623	1,059,241	1,114,966	976,616	776,680
Exposures to enterprises	CZK '000	16,442,222	16,912,362	4,904,965	14,596,311	17,342,648
Exposures to retail	CZK '000	520,986	692,337	1,428,522	1,953,670	71,936
Exposures secured by property	CZK '000	95,616	89,595	156,394	130,822	90,453
Exposures in default	CZK '000	871,180	565,639	493,518	618,619	827,920
High-risk exposures	CZK '000	0	0	0	0	1,017,563

Indikator	Unit	2012	2013	2014	2015	2016
Exposures in covered bonds	CZK '000	578,004	671,612	144,034	62,779	61,462
Exposures to institutions and enterprises with short-term credit evaluation	CZK '000	41,343	26,379	77,467	98,978	39,436
Collective investment instruments	CZK '000	0	0	0	0	0
Equities	CZK '000	0	0	1,347	1,347	1,347
Other exposures	CZK '000	68,461	64,247	208,016	196,133	186,067
Risk exposure relating to position, foreign exchange and commodity risks pursuant to the Standardised Approach	CZK '000	**2,804,401**	**622,385**	**592,813**	**102,907**	**0**
Tradable debt instruments	CZK '000	2,804,401	622,385	592,813	102,907	0
Currency transactions	CZK '000	0	0	0	0	0
Total risk exposure relating to operational risk	CZK '000	**2,985,113**	**3,035,223**	**2,909,928**	**2,678,764**	**1,945,764**
Operational risk – basic indicator approach	CZK '000	2,985,113	3,035,223	2,909,928	2,678,764	1,945,764
Total risk exposure relating to revaluation adjustments to credit risk	CZK '000	0	0	294,988	122,768	137,256
Standardised Approach	CZK '000	0	0	294,988	122,768	137,256
Capital ratio for Tier 1 equity capital	%	14.40	16.03	17.14	18.46	19.93
Capital ratio for Tier 1 capital	%	14.40	16.03	17.14	18.46	19.93
Capital ratio for total capital	%	14.40	16.03	17.14	18.46	19.93
Return on average assets (ROAA)[1]	%	1.19	0.41	0.35	0.24	0.04
Return on average equity (ROAE)[1]	%	18.57	9.02	6.81	5.01	0.68
Assets per employee[1]	CZK '000	514,772	445,646	595,033	148,322	130,246
Administrative costs per employee[1]	CZK '000	1,399	1,356	1,455	1,438	1,474
Net profit per employee[1]	CZK '000	3,740	1,583	1,226	939	130

Reconciliation of regulatory and accounting capital

The following tables summarise the composition of regulatory and accounting capital as well as individual indicators as of 31 December 2016 and 31 December 2015, thus providing complete reconciliation of individual regulatory capital lines with the institution's capital and the balance sheet.

As of 31 December 2016	**Regulatory capital CZK mil.**	**Shareholder's equity CZK mil.**
Paid-in share capital entered in the Commercial Register	2,632	2,632
(–) Capital investments into own instruments	0	0
Retained earnings from previous periods	756	756
Profit for the period	0	28
Accumulated other comprehensive income	0	604
Other reserve funds	1,150	1,339
(–) Value adjustments pursuant to prudential revaluation requirements (additional value adjustments)	-1	-
(–) Intangible assets other than goodwill	-21	-
(–) Adjustments relating to unrealised gains and losses	-	-
Total capital eligible for inclusion into Tier 1	**4,516**	
Total shareholder's equity		**5,359**
Total Tier 2 capital	0	
Capital relevant for calculating large exposure limits, qualified participation limits and capital ratio	**4,516**	

[1] Calculations were made pursuant to Decree No. 163/2014 Coll., on performing the activities of banks, credit unions and investment firms.

As of 31 December 2015	**Regulatory capital CZK mil.**	**Shareholder's equity CZK mil.**
Paid-in share capital entered in the Commercial Register	2,132	2,132
(–) Capital investments into own instruments	0	0
Retained earnings from previous periods	756,	756
Profit for the period	0	196
Accumulated other comprehensive income	641	641
Other reserve funds	1,150	1,150
(–) Value adjustments pursuant to prudential revaluation requirements (additional value adjustments)	-2	-
(–) Intangible assets other than goodwill	-23	-
(–) Adjustments relating to unrealised gains and losses	**-641**	-
Total capital eligible for inclusion into Tier 1	**4,013**	
Total shareholder's equity		**4,875**
Total Tier 2 capital	0	
Capital relevant for calculating large exposure limits, qualified participation limits and capital ratio	**4,013**	

1/ Product overview

During 2016, the Bank provided the following products:

a) Guarantees

- Guarantees for bank loans provided by a simplified procedure and with a limited guaranteed amount for a portfolio of guaranteed loans (hereinafter just "portfolio guarantees") provided under the GUARANTEE 2015-2023 Programme (to small enterprises) for loans up to CZK 4 million and to as much as 70% of the loan principal;
- Guarantees for bank loans to as much as 80% of the loan principal in the maximum guarantee amount of CZK 30 million (hereinafter referred to as "individual guarantees") provided to (small and medium-sized) social enterprises within the GUARANTEE 2015-2023 Programme, including a financial contribution of 10% of the guaranteed loan amount drawn for eligible costs up to CZK 500,000;
- Guarantees for tender bids for small and medium-sized enterprises in amounts of CZK 50,000 to CZK 5 million; and
- Guarantees for bank loans under the INOSTART Programme for start-up small and medium-sized enterprises implementing innovative projects anywhere in the Czech Republic for loans up to CZK 15 million and up to 60% of the loan principal.

b) Loans

- Loans for small enterprises in the South Bohemia Region in amounts up to CZK 1 million, with a fixed interest rate of 4% p.a. and maturity up to 6 years under the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemian Region;
- Loans for municipalities in the South Bohemian Region in amounts up to CZK 2 million with a fixed interest rate that is continuously updated for new loans according to the development of market interest rates and maturity up to 10 years under the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemia Region;
- Long-term loans funded by the Regional Development Fund for municipalities or associations of municipalities (with the exception of the Capital City of Prague) to co-finance projects for improving local infrastructure for business and non-business purposes in amounts up to CZK 30 million, with a preferential fixed or variable interest rate determined individually according to current market conditions, maturity up to 10 years and a grace period up to 3 years.

2/ Support to small and medium-sized enterprises

a) Overall results

CMZRB provided support to small and medium-sized enterprises (hereinafter just SMEs) especially on the basis of agreements concluded with the Ministry of Industry and Trade.

Guarantees for investment loans and loans for the purchase of inventory were provided under the GUARANTEE 2015–2023 Programme with support from national resources and an EIF counter-guarantee. The outcome from implementing this programme, which was designated primarily for small enterprises, confirms their growing interest in using guarantees. An increase in the proportion of supported investment loans was also apparent in 2016.

Provision of guarantees for loans to start-up enterprises for innovative projects within the INOSTART Programme continued in 2016 across the entire Czech Republic. Loans supported by guarantees from CMZRB are provided by Česká spořitelna, a.s.

Based on an agreement with the South Bohemia Region, preferential loans were provided to small enterprises. In 2016, SMEs submitted a total of 2,078 applications for support in the forms of loan guarantees and loans (see Table 1). Of this number, 1,848 applications were approved and 10 applications were rejected. Another 114 applications were withdrawn by the applicants during processing. The remaining 106 applications were not resolved in 2016 and will carry over into 2017.

Applications for support and their settlement — Table 1

Indicator		2012	2013	2014	2015	2016
Total applications submitted	Number	1,095	1,903	2,423	3,275	2,078
Approved	Number	793	1,563	1,988	2,688	1,848
Rejected or withdrawn	Number	125	229	210	581	124
Carried into following year	Number	177	111	225	6	106

The loans and guarantees provided were directed to small enterprises with up to 49 employees (see Table 2).

Supported projects divided according to sizes of enterprises — Table 2

	Guarantees (excluding bids to public tenders)				Loans			
	Number		Amount		Number		Amount	
Number of employees		**(%)**	**CZK mil.**	**(%)**		**(%)**	**CZK mil.**	**(%)**
0 to 9	1,206	65.6	2,097.5	59.4	8	88.9	6.0	85.7
10 to 49	626	34.0	1,412.0	40.0	1	11.1	1.0	14.3
50 to 249	7	0.4	20.8	0.6	0	0.0	0.0	0.0
Total	**1,839**	**100.0**	**3,530.3**	**100.0**	**9**	**100.0**	**7.0**	**100.0**

b) Guarantees

Based on guarantee contracts concluded in 2016, the Bank provided 1,839 loan guarantees in a total amount of CZK 3,530 million. The guarantees supported loans of CZK 5,055 million (see Table 3).

Guarantees issued and loans guaranteed (excluding bids to public tenders) — Table 3

Indicator		2012	2013	2014	2015	2016
Guarantees issued	Number	697	1,546	1,952	2,661	1,839
Amount of guarantees issued	CZK mil.	1,534	3,251	4,010	6,913	3,530
Amount of loans guaranteed	CZK mil.	2,215	4,616	5,711	9,947	5,055
Average guarantee coverage	%	69	70	70	70	70

In the national programme GUARANTEE 2015-2023, programme call II, SMEs obtained guarantees in the amount of CZK 3,475. These guarantees were used as security for 1,824 loans in amounts totalling CZK 4,963 million.

Start-up enterprises were provided with 15 guarantees in total volume CZK 55 million within the INOSTART Programme.

The largest proportions of guarantees presented in Table 3 were used to support projects in the Capital City of Prague, the Moravian-Silesian Region, and the South Moravian Region (see Table 4).

Regional structure of guarantees provided
(in % of contracted value of guarantees issued)

Table 4

Region		2012	2013	2014	2015	2016
Praha (Capital City of Prague)	%	8.1	11.2	14.2	14.7	30.9
Středočeský (Central Bohemia)	%	4.8	8.2	10.6	10.2	8.0
Jihočeský (South Bohemia)	%	7.5	5.5	5.9	7.5	4.4
Plzeňský (Pilsen)	%	4.3	4.6	4.7	5.6	4.6
Karlovarský (Karlovy Vary)	%	2.2	1.5	1.1	1.4	0.9
Ústecký (Ústí nad Labem)	%	3.0	3.7	2.8	3.3	2.5
Liberecký (Liberec)	%	5.1	3.9	3.3	3.1	2.0
Královéhradecký (Hradec Králové)	%	5.1	4.6	4.6	6.2	3.8
Pardubický (Pardubice)	%	5.2	4.7	4.1	4.1	3.8
Vysočina (Bohemian-Moravian Highlands)	%	5.4	3.1	3.1	3.2	3.3
Jihomoravský (South Moravia)	%	8.4	14.0	13.1	12.8	13.0
Olomoucký (Olomouc)	%	15.4	6.8	8.0	7.3	5.0
Zlínský (Zlín)	%	4.5	6.0	4.7	5.2	5.4
Moravskoslezský (Moravia-Silesia)	%	20.8	22.2	19.8	15.4	12.4
Total	%	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Based on a commitment to extend the guarantee period, the Bank prolonged this period through amendments to guarantee contracts for 2,135 guarantees summing to CZK 5,288 million. This enabled entrepreneurs to draw additional credit to finance working capital needs.

In addition to guarantees for bank loans, 260 guarantees were provided for bids to public tenders totalling CZK 132 million.

The largest portion of guarantees was provided to projects in wholesale and retail, followed by manufacturing (see Table 5).

Sector structure of guarantees provided in 2016
(in % of contracted value of newly issued guarantees)

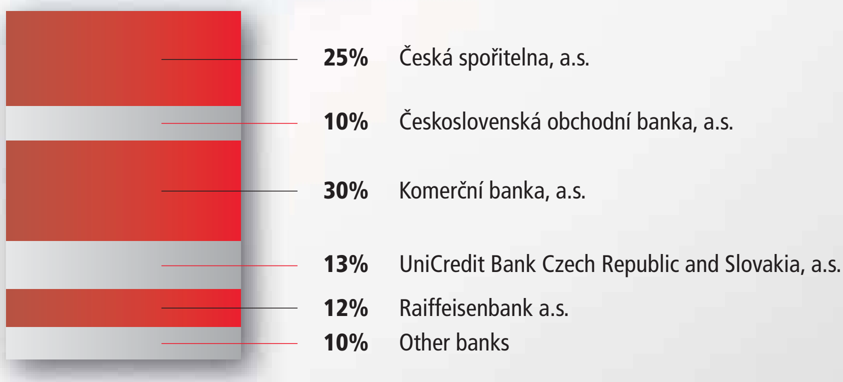
Table 5

Sector		
Manufacturing (CZ NACE 10-33)	%	12.9
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	0.0
Construction (CZ NACE 41-43)	%	7.4
Wholesale and retail trade; repair and maintenance of motor vehicles (CZ NACE 45-47)	%	60.5
Accommodation and food service activities (CZ NACE 55-56)	%	5.0
Other service activities (CZ NACE 05-09, 36-39, 49-53, 58-75, 77-82, 84-88, 90-99)	%	14.2
Total	%	**100.0**

A breakdown of the most important co-operating banks is presented in Graph 1. During 2016, the majority of guaranteed transactions were concluded with Komerční banka, a.s., and Česká spořitelna, a.s.

Graph 1

Percentage breakdown of guarantee transactions by lending banks (2016)



c) Loans

Due to the high liquidity among commercial banks and high market coverage of available commercial products, there was no pressure to introduce a preferential loan instrument which would support the development of SMEs. This situation resulted in a low number of loans being provided in 2016, wherein loans were provided only within the South Bohemian Regional Programme. In total, 9 loans summing to CZK 7 million have been provided within the programme.

3/ Support for reconstructing apartment houses

In 2016, the Bank administered a total of 9,089 active Contracts on Providing Grants to Cover Loan Interest (of the original 10,122 contracts concluded). On the basis of these, it paid out more than CZK 829 million. From the start of the programme in support of apartment house reconstruction until the end of 2016, grant recipients were collectively paid a total of CZK 8,699 million, which comprises 63.7% of the total volume of concluded Contracts on Providing Grants to Cover Loan Interest (CZK 13,664 million).

The Bank also administered a portfolio of bank loan guarantees during 2016 which enabled owners or co-owners of apartment houses to obtain loans for their repair. As of the end of 2016, this portfolio consisted of 1,366 bank loan guarantees (of which 106 were portfolio guarantees), and the unpaid principal of the guaranteed loans amounted to CZK 3,479 million.

4/ Financing municipal infrastructure

a) Loans from the Regional Development Fund

Loans from the Regional Development Fund are designated for projects aimed at transportation and technical infrastructure, construction of commercial real estate for business activities, as well as sport, cultural and educational facilities. Issuance of these loans is dependent on the generation of sufficient funds from repayment of loans from previous years. In 2016, the Bank provided 2 loans totalling CZK 6.2 million. Since announcing the programme with new conditions in 2008, 41 loans have been issued amounting to CZK 370 million.

b) Loans from the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemian Region

Loans from the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemian Region are designated for projects focused on preserving and developing non-commercial technical infrastructure owned by municipalities within the Region.
The programme was announced only at the start of the second half of 2016, and thus the Bank did not conclude any new loan contracts.

5/ Trading on financial markets

In 2016, the Bank concluded transactions on the money and capital markets. The main purposes were to manage its liquidity through money market instruments, administer its portfolios of bonds, manage interest-rate and currency risks, and refinance the lending programme for supporting SMEs and municipalities. In administering its portfolio of bonds and money market instruments, the Bank again maintained its conservative investment strategy and was oriented primarily to purchasing government bonds, treasury bills and bonds of a selected group of issuers with high credit ratings.

6/ Other lending activities

As a financial manager for infrastructure programmes, the Bank secured financing for these programmes totalling CZK 3,484 million during 2016. Said financing comprised resources from the State Fund for Transport Infrastructure and was designated for Czech Motorways Project B, which takes in construction of the Lovosice–Ústí nad Labem section of the D8 motorway and the Osičky–Hradec Králové section of the D11 motorway.

In 2016, the Bank continued administering interest rate subsidies for participants in the Project for Construction and Renovation of Water Supply and Sewerage Infrastructure, paying out more than CZK 19 million to 95 recipients. Since the start of this programme in 2009, the total volume of disbursed interest rate subsidies had reached CZK 196.4 million as of 31 December 2016.

In the past year, the Bank undertook a fundamental reconstruction of its website. The new one symbolises a change transition and qualitative shift in its external communication and corresponds to the latest trends and requirements for institutions of such character. It reflects the Bank's more open and dynamic approach to providing information to its partners and clients. Correctly managed and targeted communication will be an important element in building support for the changes the Bank will need to undergo, both externally and internally.

Preparations for the Bank's implementation of the ESI funds scheme, continuation of the GUARANTEE 2015-2023 and INOSTART programmes, and the Bank's participation in defining the basic direction of its new orientation have required frequent, expertise-demanding, time-consuming negotiations with the shareholder's representatives, other state authorities, the Czech National Bank, commercial banks, and leasing companies. This dialogue was aimed at the preparation of the Bank's new activities as well as key strategic changes. Moreover, it helped to bring within reach the launch of financial instruments in the Operational Programme Enterprise and Innovations for Competitiveness, together with the extension the Bank's group of partners involved in using financial instruments. Another tangible outcome is approval of the ENERG Programme focused on supporting energy savings and use of renewable energy sources for entrepreneurs in Prague. The initiation of the project of the Bank's transformation into a national development bank is of fundamental importance for its further development.

Wholly new types of the Bank's activities are seen in participation of the Czech Republic in the Central-European Fund of Funds. Its preparation also took place over the past year. Resources from the state budget will be contributed through CMZRB on the basis of a government decree. The process for acquiring a CNB licence to provide depositary services for the National Investment Fund (NIF) also continued, and part of the funds of the Operational Programme Enterprise and Innovations for Competitiveness should be used through the NIF as capital inputs to support start-up enterprises.

The increase in the Bank's capital approved by the government at the end of 2015 was possible only after several months of dialogue with the European Commission, which confirmed the validity of the changes in the Bank's profile initiated by the change in shareholder structure in 2012. The Bank was thus able to fulfil the requirements for so-called special credit institutions, and in November 2016 it increased the share capital by CZK 0.5 billion without detailed prior verification of this step's compliance with state aid rules. At the same time, this opened the possibility to further raise the Bank's share capital if fulfilment of its role as a development bank would require such measure.

The Bank's most important business activity in 2016 was an involvement in using resources from the European Fund for Strategic Investments (EFSI), the so-called Juncker plan, implemented through a counter-guarantee provided by the European Investment Fund. Hence, it was connected with various media activities and other presentations. Specific results of the measures within the Investment Plan for Europe, the financing of which is served by the EFSI, were presented to the public both in the Czech Republic and within the EU. The Bank thus had the opportunity to present the very good results it achieved in this area and which contributed to the Czech Republic's keeping pace in using this part of the EFSI directed to SME support.

The Czech Banking Association's Working Group for Cohesion Policy was the main platform for CMZRB's co-operation with commercial banks in methodological and organisational preparations for co-financing projects supported by financial instruments from EU structural funds. Numerous working contacts between CMZRB and the banks proceeded also at regional level and contributed substantially to the very good results in providing guarantees. They will form a good basis for further expansion in 2017.

Co-operation with trade associations and other entities was ongoing and in various forms, thereby broadening the interested parties' awareness as to the individual types of support. Through this channel, too, knowledge was acquired as to the current needs and problems of the individual target groups of applicants and recipients of support. The Bank used the knowledge thus obtained in order to improve the services it already provides and passed this information on to those partners responsible for defining the conditions of the provided support.

Last year, CMZRB representatives participated in a number of joint negotiations within three Europe-wide interest associations: the Network of European Financial Institutions for SMEs (NEFI), the European Association of Guarantee Institutions (AECM), and the European Long-Term Investors Association (ELTI). At the very end of 2016, the Bank hosted a meeting of NEFI members in Prague. The presented proposals of legislative changes and the communication of the European Commission confirm the growing emphasis given to increasing the efficiency of co-operation between national promotional institutions and the EIB Group implementing directly managed EU programmes to support various sectors of the economy. The active participation and joint positions of these associations submitted to the European Commission undoubtedly contributed to promoting an understanding of the importance and role that national development institutions may have. The Bank's involvement in these networks also helped in obtaining necessary information about how promotional institutions operate abroad. Moreover, it will be used in implementing the project on establishing a national development bank in the Czech Republic.

Goals for further development

The Bank's crucial goals for 2017 are to extend its offer of support for entrepreneurs and make the largest possible contribution to preparations and successful implementation of the project on transforming CMZRB into a national development bank.

An increased funding for providing guarantees, including an EIF counter-guarantee for the GUARANTEE 2015–2023 Programme and for the INOSTART Programme, will enable the Bank to maintain its offer of such guarantees at the same level as in the previous year. Small enterprises in particular will be able to use this offer to obtain guarantees for loans of as much as CZK 4 million. In the case of loans for social enterprises, this includes businesses with up to 249 employees. Their greatest added value will be in the speed of their provision and low administrative demands for applicants.

After several years of delays, the offer of preferential financing for entrepreneurs available in non-Prague regions will be extended to include preferential loans and guarantees for loans financed from structural funds in the Operational Programme Enterprise and Innovations for Competitiveness (OP EIC) managed by the Ministry of Industry and Trade. These financial instruments will be complemented in economically disadvantaged regions with interest rate subsidy on bank loans in the period up to 4 years. These measures will especially strengthen the offer for medium-sized enterprises implementing projects in the range of up to tens of millions of crowns. Moreover, they will support investments into setting-up of new establishment, extension of the capacity of existing one, diversification of the output into products not previously produced, implementing a fundamental change in the overall production process or making fundamental changes in overall manufacturing processes with a majority of expenditures spent on acquiring new machinery and equipment. The year 2017 will test the viability of this concept, which is not quite usual for financial instruments, including the co-operation among CMZRB, banks, and newly also leasing companies.

The ENERG national programme and loans in combination with interest rate subsidies within the OP EIC will offer entrepreneurs across the Czech Republic preferential financing for energy savings products. For projects in the Capital City of Prague, this also applies to financing of projects directed to using renewable sources for their activities in order to achieve savings in final energy consumption.

The government-assigned task "to elaborate a project on transforming CMZRB into a national development bank" will fundamentally influence the Bank's activities in 2017. The start of preparations at the end of last year in the form of a foundation document for the project indicated its extent and complexity. A co-ordinated joint effort by the shareholder's representatives and the Bank is a basic condition for achieving the objectives. It consists of defining the model for CMZRB's operation as a national development bank and determining the measures for its internal and external realisation. It should result in the set-up of the implementation plan for CMZRB's transformation into a development bank functioning as an instrument of the government through targeted interventions stimulating investment in various areas of economy.

The vision which the Bank will strive to support is as follows:

- To create an institution with strong capital and expert capability which is able to prepare an offer of financial products for implementing the government's policies and strategies, consequently communicating it to the financial sector and final beneficiaries of such products, including products' administration;
- To heighten the efficiency of using national and European public funds in economic interventions through financial instruments instead of grants;
- To increase the attractiveness of investing private funds together with the state;
- To increase the Czech Republic's share in using programmes of financial instruments administered by EIB and EIF.

The set of other tasks necessary to be resolved in connection with the legislative changes will also receive attention. These include implementing changes from the act on measures against legitimisation of proceeds of crime, act on consumer credits, publishing data on support exceeding EUR 0.5 million, as well as preparations for new international accounting standards. The Bank's website and use of social networks will also be further developed, and new products will be prepared according to the needs of the Bank's partners. To ensure reliable operation and compliance with increasing demands for security standards, a generational change and development of the Bank's information system will be performed, thereby contributing also to expanded process digitalisation and greater client convenience.

Report of the Supervisory Board of Českomoravská záruční a rozvojová banka, a.s.

The Supervisory Board regularly carried out its duties during 2016 as defined by law and the Articles of Association of Českomoravská záruční a rozvojová banka, a.s. In its capacity as the Bank's oversight body, the Supervisory Board monitored the work of the Board of Directors in discharging its duties, conducting the Bank's business activities and financial management, and executing is strategic policy. The Supervisory Board was regularly informed about the Bank's activities, its financial situation and other essential matters.

Having examined the financial statements for the year ended 31 December 2016, and on the basis of the external auditor's report, the Supervisory Board states that the accounting records and books were kept in a transparent manner and in compliance with the generally binding accounting regulations for banks as well as with the Articles of Association of the Bank. The accounting records and books reflect the Bank's actual financial situation in all important respects.

KPMG Česká republika Audit, s.r.o., performed an audit of the financial statements and confirmed that the financial statements provide a true and fair view of the financial position of Českomoravská záruční a rozvojová banka, a.s., as of 31 December 2016 and of its operations for that year in accordance with Czech accounting standards. The Supervisory Board acknowledged the auditor's report by consent.

The Supervisory Board reviewed without comment the Report of the Board of Directors on the Bank's Business Activities and Financial Situation for 2016. It likewise examined the Report of the Board of Directors on Relations between Related Entities for 2016.

Based upon the facts stated above and pursuant to the Articles of Association of Českomoravská záruční a rozvojová banka, a.s., the Supervisory Board recommended that the following be submitted for approval by decision of the sole shareholder in exercising the powers of the General Meeting as presented by the Bank's Board of Directors: Report of the Board of Directors on the Bank's Business Activities and Financial Situation for 2016, Report of the Board of Directors on Relations between Related Entities for 2016, and the financial statements of Českomoravská záruční a rozvojová banka, a.s., for 2016.

The Supervisory Board also reviewed the following proposals presented by the Bank's Board of Directors: the profit distribution for 2016, the financial and business plan for 2017, remuneration of the members of the Bank's bodies for 2016 (Supervisory Board and Audit Committee), and the policies for remunerating members of the Bank's bodies (Supervisory Board and the Audit Committee) in the following period and recommended their submission for approval by decision of the sole shareholder in exercising the powers of the General Meeting of Českomoravská záruční a rozvojová banka, a.s.

Prague, 21 March 2017

On behalf of the Supervisory Board of Českomoravská záruční a rozvojová banka, a.s.:

Robert Szurman
Chairman of the Supervisory Board

Report of the Audit Committee of Českomoravská záruční a rozvojová banka, a.s.

During 2016, the Audit Committee fulfilled its responsibilities and carried out its duties as defined by Act No. 93/2009 Coll., on Auditors; by Decree of the Czech National Bank No. 163/2014 Coll., on the performance of the activity of banks, credit unions and investment firms; and by the Articles of Association of Českomoravská záruční a rozvojová banka, a.s. (hereinafter referred to as the “Bank”).

Within its competence, the Audit Committee oversaw in 2016 the process of compiling the Bank’s financial statements for 2015 and that of their mandatory audit as executed by the auditor KPMG Česká republika Audit, s.r.o. It further appraised the independence of the audit firm KPMG Česká republika Audit, s.r.o., and the character of additional services provided by the external auditor, concluding that on the basis of the presented documents the external auditor may be regarded as independent. The external auditor also submitted to the Audit Committee the report on verifying the Bank’s management and control systems (market risk) and the MiFID 2015 report. Last year’s co-operation with the external auditor proceeded without issue.

In accordance with the amended Act on Auditors, the Audit Committee discussed the contract “Income tax returns for legal entities, Tax advisory” concluded with KPMG Česká republika, s.r.o., and on the basis thereof approved the provision of non-audit services to the Bank by KPMG Česká republika, s.r.o.

Based upon an evaluation of the public tender “Audit Services 2016-2019” conducted within the Bank during December 2015-January 2016 and with active participation of the Audit Committee, the Audit Committee recommended KPMG Česká republika Audit, s.r.o., to the Bank’s Supervisory Board as external auditor to perform the mandatory audit for 2016-2019 and duly explained its recommendation.

At its regular meetings, the Audit Committee discussed evaluations as to the effectiveness of the Bank’s management and control systems and the activities of the Bank’s Internal Audit Unit. The Audit Committee stated that the systems established within the Bank are functional and efficient and that the measures adopted in relation to the audit findings were satisfactorily followed.

During 2016, the Audit Committee also reviewed the Report on the Information Systems Audit, which was conducted by the audit firm Deloitte Advisory s.r.o., as well as information on the security of communication networks, especially from the perspective of possible breaches in the Bank’s information systems.

The Audit Committee in 2016 also fulfilled its responsibilities and carried out its duties as established for the Risk Committee, which had been added into the Audit Committee’s competence in October 2014.

In exercising the function of the Risk Committee, the Audit Committee evaluated the Bank’s system of financial risk management; the report on valuing assets, liabilities and off-balance sheet items and their reflection in the offer to clients, which took into account the business model and strategies for risk; and information about the risks, capital, liquidity, and probability and timing of expected profit and their reflection in the overall system of remuneration.

The Chairman of the Audit Committee regularly informed the Bank’s Supervisory Board as to the results of the Audit Committee’s meetings.

Prague, 21 March 2017

On behalf of the Audit Committee of Českomoravská záruční a rozvojová banka, a.s.:

Milan Novák
Chairman of the Audit Committee

Independent auditor's report to shareholders of Českomoravská záruční a rozvojová banka, a.s.

2016

annual review

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Independent Auditor's Report to the Shareholders of Českomoravská záruční a rozvojová banka, a.s.

Opinion

We have audited the accompanying financial statements of Českomoravská záruční a rozvojová banka, a.s. ("the Company"), prepared in accordance with International Financial Reporting Standards as adopted by the European Union, which comprise the statement of financial position as at 31 December 2016, and the statement of comprehensive income, the statement of changes in equity and the cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory notes. Information about the Company is set out in Note 1 to the financial statements.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Basis for Opinion

We conducted our audit in accordance with the Act on Auditors, and Auditing Standards of the Chamber of Auditors of the Czech Republic, consisting of International Standards on Auditing (ISAs) as amended by relevant application guidelines. Our responsibilities under those regulations are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the Act on Auditors and the Code of Ethics adopted by the Chamber of Auditors of the Czech Republic, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Statutory Body, Supervisory Board and Audit Committee for the Financial Statements

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

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

The Supervisory Board and Audit Committee are responsible for the oversight of the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the above regulations will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the above regulations, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

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

obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

Auditor Responsible for the Engagement

Veronika Strolená is the auditor responsible for the audit of the financial statements of Českomoravská záruční a rozvojová banka, a.s. as at 31 December 2016, based on which this independent auditor's report has been prepared.

Prague
28 March 2017

KPMG Česká republika Audit, s.r.o.
Registration number 71

Veronika Strolená
Director
Registration number 2195

Financial statements for the year ended 31 December 2016
prepared in accordance with IFRS as adopted by the EU

2016
annual review

	Note	Year ended 31 December 2016 CZKm	Year ended 31 December 2015 CZKm
Interest and similar income		648	830
Interest and similar expenses		(277)	(373)
Net interest income	**3.1**	**371**	**457**
Fee and commission income		323	388
Fee and commission expenses		(2)	(3)
Net fee and commission income	**3.2**	**321**	**385**
Gains from financial operations	3.3	41	114
Losses on financial operations	3.3	(34)	(80)
Administrative expenses	3.4	(351)	(340)
Increase in loan impairment and write-offs	3.5	(61)	(116)
(Increase)/decrease in provisions for guarantees and other provisions	3.6	8	(161)
Other operating income		(136)	-
Operating profit		**159**	**259**
Share of earnings in associates accounted for using the equity method	3.15	-	3
Profit before income tax		**159**	**262**
Income tax expense	3.7	(139)	(70)
Profit for the year		**20**	**192**

Statement of comprehensive income

	Note	Year ended 31 December 2016 CZKm	Year ended 31 December 2015 CZKm
Profit for the year		**20**	**192**
Other comprehensive income			
Valuation gains/(losses) on available-for-sale financial assets		(11)	202
Net gains/(losses) on available-for-sale financial assets transferred to income statement on disposal	3.3	(34)	(46
Deferred income tax relating to components of the comprehensive income	3.7	8	(29)
Other comprehensive income for the year, net of tax		(37)	127
Total comprehensive income		**(17)**	**319**

	Note	31 December 2016 CZKm	31 December 2015 CZKm
Assets			
Cash and balances with central banks	3.8	8	120
Loans and advances to banks	3.9	86	261
Financial assets held for trading			
- Debt securities	3.10	-	113
- Derivatives	4.2.2	80	103
Debt securities designated at fair value	3.10	529	965
Loans and advances to customers	3.11	6,691	9,057
Financial assets available for sale	3.12	14,829	14,912
of which: assets pledged as collateral		862	6,245
Financial assets held to maturity	3.13	5,145	5,188
of which: assets pledged as collateral		-	917
Current income tax assets	3.7	36	62
Investment in associate	3.15	108	108
Intangible assets		21	23
Property, plant and equipment	3.16	124	131
Other assets	3.14	62	64
Total assets		**27,719**	**31,107**
Liabilities			
Deposits from banks	3.17	6,849	9,742
Deposits from customers	3.18	11,263	11,706
Financial liabilities held for trading - derivatives	4.2	93	208
Hedging derivatives	4.2.2	29	36
Current income tax liabilities	3.7	-	-
Deferred tax liabilities	3.7	129	35
Provisions	3.6	3,165	3,124
Other liabilities	3.19	733	1,281
Total liabilities		**22,261**	**26,132**
Shareholders' equity			
Share capital	3.20	2,632	2,132
Statutory and other reserves		1,339	1,150
Revaluation reserve for AFS securities		604	641
Retained earnings		883	1,052
Total shareholders' equity		**5,458**	**4,975**
Total liabilities and shareholders' equity		**27,719**	**31,107**

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

These financial statements were prepared by the Bank and approved by the Board of Directors of the Bank on 28 March 2017.

Jiří Jirásek
Chairman of the Board

Ivan Duda
Member of the Board

Statement of changes in equity

	Share capital	Statutory and other reserves	Own treasury shares	Revaluation reserve for AFS securities	Retained earnings	Total
	CZKm	CZKm	CZKm	CZKm	CZKm	CZKm
Balance at 1 January 2015	**2,132**	**1,150**	**(776)**	**514**	**1,773**	**4,793**
Profit for the period	-	-	-	-	192	192
Net fair value gains on AFS securities	-	-	-	202	-	202
Net gains on AFS securities transferred to income statement	-	-	-	(46)	-	(46)
Deferred income tax relating to components of other comprehensive income	-	-	-	(29)	-	(29)
Total comprehensive income	-	-	-	127	192	319
Dividends relating to 2014	-	-	776	-	(913)	(137)
Balance at 31 December 2015	**2,13**	**1,150**	**-**	**641**	**1,052**	**4,975**
Profit for the period	-	-	-	-	20	20
Net fair value gains on AFS securities	-	-	-	(11)	-	(11)
Net gains on AFS securities transferred to income statement	-	-	-	(34)	-	(34)
Deferred income tax relating to components of other comprehensive income	-	-	-	8	-	8
Total comprehensive income	-	-	-	(37)	20	(17)
Share issue	500					500
Allocation of profit to other funds	-	189	-	-	(189)	-
Balance at 31 December 2016	**2,632**	**1,339**	**-**	**604**	**883**	**5,458**

	Note	2016 CZKm	2015 CZKm
Profit before income tax		159	262
Adjustments for non-cash transactions			
Loans impairment and write-offs and provisions for guarantees		53	277
Depreciation and amortization		31	33
Share of profit of associates		-	(3)
Change in fair values and foreign exchange differences		(124)	(64)
Other non-cash items		14	16
Net interest income		(371)	(457)
Fee and commission income		(323)	(388)
		(561)	(324)
(Increase)/decrease in operating assets			
Loans and advances to banks		115	(42)
Loans and advances to customers		2,657	2,837
Other assets		567	469
Increase/(decrease) in operating liabilities			
Deposits from banks		(2,879)	(4,559)
Deposits from customers		(442)	(92,243)
Other liabilities		(319)	431
Interest received		693	901
Interest paid		(241)	(337)
Fee and commission received		147	139
Net cash flow from operating activities before income tax and payments under guarantee calls		(263)	(92,728)
Payments made under guarantee calls		(373)	(368)
Income taxes paid		(73)	(159)
Net cash flow from operating activities		**(709)**	**(93,255)**
Cash flows from investing activities			
Purchases of securities		(1,602)	(3,906)
Sales of securities and proceeds from matured securities		1,675	6,258
Purchase of tangible and intangible assets		(35)	(34)
Net cash flow from investing activities		**(671)**	**(90,937)**
Cash flows from financing activities			
Capital increase		500	-
Dividends paid		-	(137)
Net cash flow from financing activities		**500**	**(137)**
Net increase/ (decrease) in cash and cash equivalents		**(171)**	**(91,074)**
Cash and cash equivalents at the beginning of the year	**3.21**	**187**	**91,261**
Cash and cash equivalents at the end of the year	**3.21**	**16**	**187**

Notes to the financial statements

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1/ General information

Českomoravská záruční a rozvojová banka, akciová společnost (henceforth the "Bank" or "ČMZRB") was formed as a joint stock company pursuant to the Czech Commercial Code and was incorporated in 1992. The Bank's registered office is located at Jeruzalémská 964/4, Prague 1, Czech Republic. The Bank has five branches in the Czech Republic (in Brno, Hradec Králové, Ostrava, Plzeň and Prague) and one regional office in České Budějovice.

The Bank's activities are focused on supporting small and medium-sized businesses in the Czech Republic by providing preferential loans (Note 2 d), preferential guarantees (Note 2 j) and issuing infrastructure loans to municipalities and their legal associations, as well as water sector entities with municipal equity participations (Note 2 b). The Bank's loan portfolio includes also loans to the Ministry of Finance provided in connection with infrastructure programs (Note 3.11). The Bank also acts as an agent disbursing Czech government agency's funds as subsidy of interest costs to the block of flats' owners that meet specified criteria (Note 2 f). The purpose-bound funds are made available to Bank by the Czech state and international financial institutions. In some cases the Bank participates on program funding.

These financial statements include the Bank and its associated undertaking MUFIS a.s. (see Note 3.15), together the "Group".

Use of Bank's resources for financing subsidies of SMEs ("Small and medium enterprises") in 2016

Because of the delay in commencement of providing financial instruments in Operational program Enterprise and innovations for competitiveness Bank used own resources for co-financing guarantees for SMEs in national guarantees' program. This enabled maintaining continuity in support for SMEs in 2016.

2/ Summary of significant accounting policies

(a) Basis of preparation

The financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS'). The financial statements comprise the income statement and statement of comprehensive income presented as two separate statements, the statement of financial position, the statement of changes in equity, the statement of cash flows and the notes.

The financial statements have been prepared under the historical cost convention, except for available-for-sale financial assets, financial assets held at fair value through profit or loss and all derivative contracts that have been measured at fair value.

The accompanying financial statements are based on the accounting records, together with appropriate adjustments and reclassifications necessary for fair presentation in accordance with IFRS.

The financial statements are presented in CZK, which is the Bank's functional and presentation currency. The figures shown in the financial statements are stated in CZK million.

Cash and cash equivalents in the statement of cash flows include highly liquid investments. Note 3.21 shows in which item of the statement of financial position cash and cash equivalents are included.

The cash flows from operating activities are determined by using the indirect method. Profit before tax in the statement of cash flows is therefore adjusted by non-cash items, such as measurement gains or losses, changes in provisions, as well as changes from receivables and liabilities. In addition, all income and expenses from cash transactions that are attributable to investing or financing activities are eliminated. Interest received or paid is classified as operating cash flows.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. Management believes that the underlying assumptions are appropriate and that the Bank's financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2 p.

New Standards, Amendments and Interpretations adopted since 1 January 2016

The following revised standards effective from 1 January 2016 are mandatory and relevant for the Bank and have been applied by the Bank since 1 January 2016.

Amendments to IFRS 11 - Accounting for Acquisitions of Interests in Joint Operations

These Amendments require business combination accounting to be applied to acquisitions of interests in a joint operation that constitutes a business.

Business combination accounting also applies to the acquisition of additional interests in a joint operation while the joint operator retains joint control. The additional interest acquired will be measured at fair value. The previously held interests in the joint operation will not be remeasured.

Amendments to IAS 1

The Amendments to IAS 1 include the following five, narrow-focus improvements to the disclosure requirements contained in the standard.

The guidance on materiality in IAS 1 has been amended to clarify that:

- Immaterial information can detract from useful information;
- Materiality applies to the whole of the financial statements;
- Materiality applies to each disclosure requirement in an IFRS.

The guidance on the order of the notes (including the accounting policies) has been amended, to:

- Remove language from IAS 1 that has been interpreted as prescribing the order of notes to the financial statements;
- Clarify that entities have flexibility about where they disclose accounting policies in the financial statements.

Amendments to IAS 16 and IAS 38 - Clarification of Acceptable Methods of Depreciation and Amortization

Revenue-based depreciation banned for property, plant and equipment.

The amendments explicitly state that revenue-based methods of depreciation cannot be used for property, plant and equipment.

New restrictive test for intangible assets

The amendments introduce a rebuttable presumption that the use of revenue-based amortization methods for intangible assets is inappropriate. This presumption can be overcome only when revenue and the consumption of the economic benefits of the intangible asset are 'highly correlated', or when the intangible asset is expressed as a measure of revenue.

Property Plant and Equipment and IAS 41 - Agriculture

These amendments result in bearer plants being in the scope of IAS 16 Property, Plant and Equipment, instead of IAS 41 Agriculture, to reflect the fact that their operation is similar to that of manufacturing.

Amendments to IAS 19 - Defined Benefit Plans: Employee Contributions

The amendments are relevant only to defined benefit plans that involve contributions from employees or third parties meeting certain criteria. Namely that they are:

- Set out in the formal terms of the plan;
- Linked to service; and
- Independent of the number of years of service.

When these criteria are met, a company is permitted (but not required) to recognize them as a reduction of the service cost in the period in which the related service is rendered.

Amendments to IAS 27 - Equity method in the separate financial statements

The amendments to IAS 27 allow an entity to use the equity method in its separate financial statements to account for investments in subsidiaries, associates and joint ventures.

Standards, interpretations and amendments to published standards that are not yet effective and are relevant for the Company's financial statements

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2016, and have not been applied in preparing these financial statements. Of these pronouncements, potentially the following will have an impact on the Bank's operations. The Bank plans to adopt this pronouncement when it becomes effective. The Bank is in the process of analyzing the likely impact on its financial statements.

IFRS 9 - Financial Instruments (2014) (Effective for annual periods beginning on or after 1 January 2018; to be applied retrospectively with some exemptions. The restatement of prior periods is not required, and is permitted only if information is available without the use of hindsight. Early application is permitted.)

This Standard replaces IAS 39, Financial Instruments: Recognition and Measurement, except that the IAS 39 exception for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities continues to apply, and entities have an accounting policy choice between applying the hedge accounting requirements of IFRS 9 or continuing to apply the existing hedge accounting requirements in IAS 39 for all hedge accounting.

Although the permissible measurement bases for financial assets – amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit and loss (FVTPL) – are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different.

A financial asset is measured at amortized cost if the following two conditions are met:

- The assets is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and,
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

In addition, for a non-trading equity instrument, a company may elect to irrevocably present subsequent changes in fair value (including foreign exchange gains and losses) in OCI. These are not reclassified to profit or loss under any circumstances.

For debt instruments measured at FVOCI, interest revenue, expected credit losses and foreign exchange gains and losses are recognized in profit or loss in the same manner as for amortized cost assets. Other gains and losses are recognized in OCI and are reclassified to profit or loss on derecognition.

The impairment model in IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model, which means that a loss event will no longer need to occur before an impairment allowance is recognized.

IFRS 9 includes a new general hedge accounting model, which aligns hedge accounting more closely with risk management. The types of hedging relationships – fair value, cash flow and foreign operation net investment – remain unchanged, but additional judgment will be required.

The standard contains new requirements to achieve, continue and discontinue hedge accounting and allows additional exposures to be designated as hedged items.

Extensive additional disclosures regarding an entity's risk management and hedging activities are required.

It is expected that the new Standard, when initially applied, will have a significant impact on the financial statements, since the classification and the measurement of the Entity's financial instruments are expected to change.

"Based on its preliminary assessment, the Bank, expects that substantially all of financial assets classified as loans and receivables under IAS 39 will continue to be measured at amortized cost under IFRS 9. At this stage it is still unclear what portion of the Bank's debt securities will be measured at FVTPL, at FVOCI or amortized cost as this determination will depend on the outcome of the business model test. It is expected that a significant portion of debt securities will be reclassified under IFRS 9 either into or out of FVOCI. It is also possible that a number of equity instruments currently classified as available for sale will be measured at FVTPL under IFRS 9, but this determination will depend on an election to be made by the entity at the date of initial application – that is 1 January 2018. The Bank has not yet decided how it will classify these instruments. It is expected that deposits from customers will be continued to be measured at amortized cost under IFRS 9. The Bank is not yet able to quantify the expected impact that the initial application of IFRS 9 will have on its IFRS statements."

Amendments to IFRS 10 and IAS 28 - Sale or contribution of assets between an investor and its associate or joint venture (The effective date has not yet been determined by the IASB, however earlier adoption is permitted.)

The Amendments clarify that in a transaction involving an associate or joint venture, the extent of gain or loss recognition depends on whether the assets sold or contributed constitute a business, such that:

- A full gain or loss is recognized when a transaction between an investor and its associate or joint venture involves the transfer of an asset or assets which constitute a business (whether it is housed in a subsidiary or not), while a partial gain or loss is recognized when a transaction between an investor and its associate or joint venture involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

The Bank does not expect that the amendments, when initially applied, will have material impact on the financial statements as the Bank has no material subsidiaries, associates or joint ventures.

Annual Improvements to IFRSs

Annual improvements to IFRSs 2014-2016 cycle were issued on 8 December 2016 and introduce two amendments to two standards and consequential amendments to other standards and interpretations that result in accounting changes for presentation, recognition or measurement purposes. The amendments on IFRS 12 Disclosure of Interest in Other Entities are effective for annual periods beginning on or after 1 January 2017 and amendments on IAS 28 Investments in Associates and Joint Ventures are effective for annual periods beginning on or after 1 January 2018; to be applied retrospectively. Earlier application is permitted.

None of these amendments are expected to have a significant impact on the financial statements of the Bank.

(b) Treatment of associated undertakings

Investments in associated undertakings are accounted for using the equity method of accounting and are initially recognized at cost. These are undertakings in which the Bank has between 20 percent and 50 percent of the voting rights, and over which the Bank exercises significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. Equity accounting involves recognizing the Bank's share of the associate's profit or loss for the period in the profit or loss. The Bank's interest in the associate is carried in the statement of financial position at an amount that reflects its share of net assets of the associate.

For summarized financial information on the associate MUFIS a.s. accounted for using the equity method, see Note 3.15.

(c) Foreign Currencies

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions (Czech National Bank official rate).

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities are recognized in the income statement.

All foreign exchange gains and losses recognized in the income statement are presented net in the income statement within 'Income from financial operations' or 'Expense on financial operations'.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as available for sale, a distinction is made between translation differences resulting from changes in amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortized cost are recognized in profit or loss, and other changes in the carrying amount, except impairment, are recognized in other comprehensive income.

(d) Financial assets and liabilities

In accordance with IAS 39, all financial assets and liabilities – which include derivative financial instruments – have to be recognized in the statement of financial position and measured in accordance with their assigned category.

Financial assets

The Bank allocates financial assets to the following IAS 39 categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its financial instruments at initial recognition.

(a) Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorized as held for trading unless they are designated and effective as hedging instruments. Bank's financial assets held for trading consist of debt instruments. These financial assets are recognized in the statement of financial position as 'Financial assets held for trading'.

Financial instruments included in this category are recognized initially at fair value; transaction costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income statement and are reported as 'Income from financial operations' or 'Expense on financial operations'. Interest income on financial assets held for trading are included in 'Interest and similar income'. The instruments are derecognized when the rights to receive cash flows have expired or the Bank has transferred substantially all the risks and rewards of ownership and the transfer qualifies for derecognizing.

The Bank designates certain financial assets upon initial recognition at fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to IAS 39, the fair value option is only applied when the following conditions are met:

- The application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise, or
- The financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis, or
- The financial assets consists of debt host and an embedded derivative that must otherwise be separated.

To reduce accounting mismatch, the fair value option is applied to certain debt securities that are hedged with cross-currency interest rate swaps but for which the hedge accounting conditions of IAS 39 are not fulfilled. The aim is to recognize the changes in the fair value of the securities together with change in the fair value of the derivatives in the income statement.

Debt securities for which the fair value option is applied are recognized in the statement of financial position as 'Financial assets designated at fair value'. Fair value changes relating to financial assets designated at fair value through profit or loss are recognized in 'Gains and (losses) on securities – changes in fair value of the securities designated at fair value through profit or loss'.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Bank includes in this category principally Loans originated by the Bank by providing money directly to a borrower.

Loans and receivables are initially recognized at fair value – which is the cash consideration to originate the loan including any transaction costs – and measured subsequently at amortized cost using the effective interest rate method. Loans and receivables are reported in the statement of financial position as loans and advances to banks or customers or as investment securities available for sale or held to maturity.

Interest on loans is included in the income statement and is reported as 'Interest and similar income'.

Preferential loans provided by the Bank

The Czech government and the Bank created various schemes to provide zero interest, low interest rate and subordinated loans to Czech enterprises that meet specified conditions (economic sectors supported by the Czech government or the European Union). The Bank participates partially on the funding of these loans, however, recognizes the full amount due from final recipient on its statement of financial position in Loans and advances to customers. To compensate to the Bank for the below-market interest rate, the Bank receives from the funding partner the fees for managing the scheme, credit risk fee and the market interest rate agreed on a yearly basis for the Bank's share on funding. Overall amount of these fees is recognized as interest and similar income.

Based on the arrangements, the Bank is effectively able to transfer part of credit risk on these loans to the government (subject to certain limits). Such arrangements represent in substance a guarantee issued by the government. Once the loans are written-off due to credit quality deterioration in accordance with the Bank's rules, the funds deposited by the government for the provision of these loans (included in Amounts due to state institutions - see Note 3.18) are settled against these amounts. The financial guarantee received is not separately recognized as a receivable and is being effectively part of the funds provided by the government.

Following collection of the receivable or its settlement against the program funding when deemed uncollectible, the receivable is derecognized, the loss exceeding the contractually agreed portion of credit risk, if any, covered by the government in respect of loans with the program would be settled by the Bank.

(c) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity, other than those that the Bank designates as available for sale and those that meet the definition of loans and receivables.

These financial assets are initially recognized at fair value including directly attributable and incremental transaction costs and measured subsequently at amortized cost, using the effective interest method.

Interest on held-to-maturity investments is included in the income statement and reported as 'Interest and similar income'. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the investment and recognized in the income statement as 'Net gains/(losses) on financial operations'. No provisions on held-to-maturity investments had to be recognized either in 2016 or 2015.

(d) Available-for-sale financial assets

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Available-for-sale financial assets are initially recognized at fair value plus transaction costs and measured subsequently at fair value with gains and losses being recognized in the statement of comprehensive income, except for impairment losses, until the financial asset is derecognized. If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognized in the statement of comprehensive income is recognized in the income statement.

However, interest calculated using the effective interest method, and foreign currency gains and losses on Bank’s bonds classified as available for sale are recognized in the income statement.

(e) Recognition

The Bank uses settlement date accounting for regular way contracts when recording financial asset transactions. The settlement (collection) date is the day on which the financial instrument is delivered (cash payment). When settlement date accounting is applied, the financial asset is recognized on the day of receipt of a financial instrument (sending of cash) and derecognized on the day of its provision (collection of cash). In case of a portfolio of financial assets measured at fair value, changes in the fair value of the financial assets are recognized from the purchase trade date to the sale trade date. Accrued interest on debt financial assets is recognized from the purchase settlement date to the sale settlement date.

All loans and receivables are recognized when funds are provided to customers. Loans and receivables are derecognized when fully repaid by the borrower or written-off.

The Bank settles and derecognizes financial liabilities at the date on which all related risks and costs attributable to the specific liability are transferred or settled.

Financial assets that are transferred to a third party but do not qualify for derecognition are presented in the statement of financial position as 'Assets pledged as collateral', if the transferee has the right to sell or repledge them.

Financial liabilities

The Bank’s holding in financial liabilities is comprised by financial liabilities at fair value through profit or loss (financial liabilities held for trading, i.e. financial derivatives and short sales), financial liabilities at amortized cost and hedging derivatives.

(a) Financial liabilities at fair value through profit or loss

In the Bank’s case, this category comprises only financial derivatives held for trading and short sales. The Bank recognizes its financial derivatives in the category held for trading unless they are designated and effective as hedging instruments. These instruments are recognized in the statement of financial position as 'Financial liabilities held for trading'.

Gains and losses arising from changes in fair value of financial liabilities classified as held for trading are included in the income statement and are reported as 'Net gains/ (losses) on financial operations'.

(b) Other liabilities measured at amortized cost

Financial liabilities that are not classified as at fair value through profit or loss fall into this category and are measured at amortized cost. Financial liabilities measured at amortized cost are principally deposits and loans from banks or customers.

Determination of fair value

The best evidence of fair value are quoted prices in an active market. If the market for a financial instrument is not active, the entity establishes the fair value by using a valuation technique.

The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same and discounted cash flow analysis.

The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.

For more complex instruments, the Bank uses developed valuation models, which are usually based on valuation methods and techniques generally recognized as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market. All the inputs to these models are market observable. The fair value of over-the-counter (OTC) derivatives is determined using valuation methods that are commonly accepted in the financial markets, such as present value techniques and option pricing models. The fair value of foreign exchange forwards is generally based on current forward exchange rates.

For the categorization of the financial instruments carried at fair value see Note 5.

Derecognition

Financial assets are derecognized when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognized when they have been redeemed or otherwise extinguished.

Collateral (bonds) furnished by the Bank under standard repurchase agreements and securities lending and borrowing transactions are not derecognized because the Bank retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met.

Reclassification of the financial assets

The Bank may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held-for-trading or available-for-sale categories if the Bank has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification. The Bank has not performed any of the reclassification or any type of other reclassifications between categories of the financial assets in 2016 or 2015.

(e) Offsetting financial instruments

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

(f) Interest and fee income and expenses

Interest income and expense are recognized in the profit and loss account for all interest bearing instruments on an accruals basis using the effective interest rate. Loan origination fees are included in the effective interest rate and are therefore reported in 'Interest income'. Other fees and commissions are recognized in the period to which they relate on an accruals basis. Interest income includes interest income for all fixed income instruments.

As part of its activities, the Bank acts as an agent disbursing government's funds as subsidy of interest costs of the loans provided by the Czech state agency to the debtors that meet specified criteria. Therefore, the grant is not recognized on the statement of financial position of the Bank. The Bank's services are: (i) it is a payment agent and (ii) the Bank processes paperwork, e.g. subsidy agreements on behalf of the government. The Bank obtains remuneration for the services provided of the agreed percentage of funds disbursed. This remuneration from the government partner is recognized as earned as it is calculated on annual basis based on the agreed contract with the provider of the assistance.

(g) Impairment of financial assets

(a) Assets carried at amortized cost

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

The Bank regularly assesses its loan portfolio for impairment. As part of this analysis, the Bank splits all loans into two categories: non-performing loans, i.e., a larger than insignificant part of the principal and interest is past due for more than 90 days, and performing loans. If there is any objective evidence that a loan may be impaired (deterioration of a debtor's financial health, payment default, etc), the amortized cost of the loan is reduced through a provision to its estimated recoverable value. The recognition, use and release of provisions are accounted for on a monthly basis always by reference to the loan balances at the month-end. The provision is reduced if objective reasons for loan impairment cease to exist. In such cases, the original amount is reversed and a required provision is released.

Provisions are used when loans are sold or written off. Provisions are released to income when the reasons for maintaining the provision cease to exist (for example, when the loan is repaid).

The Bank makes an estimate of realized losses on an individual basis for individually significant loans and on a portfolio basis for individually insignificant loans by reference to historical experience.

Management of the Bank uses estimates based on historical experience of losses on loans that have similar risk characteristics (that is, on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. The methods and assumptions adopted in estimating amounts and the timing of future cash flows are regularly reviewed to reduce differences between the estimated and actual data.

The Bank writes off loss loans when it can be reasonably anticipated that clients will be unable to fulfil their obligations to the Bank in respect of these loans. Subsequent recoveries are credited to the income statement in the line 'Decrease/increase in loan impairment and write-offs'.

For further information on credit risk refer to Note 4.1.

(b) Available for sale financial assets

The Bank performs regular assessments to determine whether available for sale financial assets suffered impairment. When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the carrying amount of the impaired security is decreased directly and at the same time the cumulative loss that had been recognized in other comprehensive income is reclassified from equity to profit or loss line 'Net gains (losses) on financial operations' as a reclassification adjustment even though the financial asset has not been derecognized. The amount of this loss reflects the difference between the cost (less the repayments of principal and amortization, if any) and the current fair value, reflecting previous impairment losses recognized in expenses.

(h) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in Due to banks or Due to customers, as appropriate.

Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

(i) Derivative financial instruments and hedging

In the normal course of business, the Bank enters into contracts for derivative financial instruments which represent a financial instrument that requires none or a very low initial investment. The derivative financial instruments used include interest rate and currency forwards and swaps. These financial instruments are held by the Bank in order to hedge interest rate risk and currency exposures associated with its transactions.

Derivative financial instruments are initially recognized at fair value and are subsequently remeasured to their fair value. Fair values are obtained from the discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

On the date a derivative contract is entered into, the Bank designates certain derivatives as an accounting hedge of the fair value of a recognized asset or liability (fair value hedge). Hedge accounting is used for derivatives and the hedged items designated in this way provided that certain criteria are met.

The Bank's criteria for a derivative instrument to be accounted for as an accounting hedge include:

(a) They meet the Bank's risk management strategy,
(b) At the inception of the hedge, the hedging relationship is formally documented, the documentation identifies the hedged item and the hedging instrument, defines the risk that is being hedged and the approach to establishing and documenting whether the hedge is effective, and

(c) The hedge is effective, that is, if, at inception and throughout the period, changes in the fair value of the hedged item are almost fully offset by changes in the fair value of the hedging instrument and the results are within a range of 80 percent to 125 percent.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that prove to be highly effective in relation to the hedged risk are recorded in profit or loss along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective element of the hedge is charged directly to profit or loss in line 'Income from financial operations' or 'Expense on financial operations'.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognized immediately in the income statement under 'Income from financial operations' or 'Expense on financial operations'.

(j) Provisions and financial guarantees obligations

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

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument.

Financial guarantee contracts

Bank provides two main types of financial guarantees:

- The financial guarantees to the small and medium enterprises in various preferential guarantee programs in cooperation with the Czech state, and
- The financial guarantees in PANEL program launched by the State Fund for Housing Development ("SFRB") in support of reconstruction and refurbishment of specific block of flats with the aim to improve their quality and lifetime.

Under the agreements concluded between the Bank and the Czech state or the Bank and SFRB, the Bank issues preferential financial guarantees for loans provided by third party banks. The difference between the full market price of the guarantee and the fee paid by client is funded by the Czech state (intermediating in some cases the programs of the European Union) or by SFRB. The Bank immediately deducts such support funded by the Czech state whole in advance from the customer's bank account as its fee for the issued financial guarantee and these fees received are recognized in the income statement over the life of the guarantee. From 2015 the Bank is remunerated for new guarantees directly by the Czech state on annual basis. The terms and conditions of the financial guarantee contracts with related parties are described in Note 3.23.

In addition, the government refunds to the Bank losses on financial guarantees issued under the schemes up to the amount agreed in the contract between the Bank and the Czech state. For these purposes the amounts are deposited within special bank account for each guarantee provided and recognized as Amounts due to state institutions (see Note 3.18).

Financial guarantees are initially recognized in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for future premiums is recognized. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial amount, less amortization of fees recognized in accordance with IAS 18, and the best estimate of the amount required to settle the guarantee (i.e. the amount determined in accordance with IAS 37 Provisions, Contingent liabilities and Contingent assets). Provisions for guarantees are made for estimated losses above the amounts deposited by the Czech state. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of the Bank's management. Risk category method applied by the Bank is considering the likelihood that an outflow will be required in settlement by considering the class of obligations (i.e. those arising from a certain type of the financial guarantees) as a whole. A provision is therefore recognized even if the likelihood of an outflow with respect to any specific item included in the same class of obligations may be small.

(k) Property, plant and equipment and intangible assets

Tangible and intangible assets are stated at historical cost less the accumulated depreciation and accumulated impairment losses. Fixed assets are depreciated through the accumulated depreciation charge. Depreciation is calculated on a straight line basis in order to write off the cost of each asset to their residual value over its estimated useful economic life. Assets in the course of construction are not depreciated.

The estimated useful economic lives are set out below:

Machinery and equipment, computers, vehicles, software	4 years
Fixtures, fittings and equipment	10 years
Buildings and structures	30 years

The Bank periodically tests its assets for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount. Where assets are identified as being surplus to the Bank's requirements, management of the Bank determines a provision for asset impairment. In respect of the assets owned by the Bank, the provision is assessed by reference to a fair value based on third party valuation reports adjusted downwards for an estimate of associated sale costs.

Repairs and renewals are charged directly to the income statement when the expenditure is incurred.

(l) Employee benefits

The Bank governs through internal guidelines provision of employee benefits. Some benefits are provided regularly to all employees (e.g. additional pension insurance); others are provided in relation to the actual need of an employee (e.g. loans).

Contributions are made to the government's retirement benefit scheme at the statutory rates in force during the year based on gross salary payments. The cost of social security payments is charged to the income statement in the same period as the related salary cost.

(m) Current and deferred income tax

Tax is calculated in accordance with the provisions of the relevant legislation of the Czech Republic based on the profit determined in accordance with the Czech Accounting Standards.

Deferred tax is provided using the statement of financial position liability method for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes.

Deferred income tax is determined using tax rates effective in the periods in which the temporary tax difference is expected to be realized. The principal temporary differences arise from specific allowances for loan losses and provisions for the guarantees and unrealized gains and losses from available for sale financial assets. Deferred tax assets in respect of tax losses carried forward and other temporary differences are recognized to the extent that it is probable that future taxable profit will be available against which the tax assets can be utilized.

Current and deferred tax are recognized as an expense or income in the income statement, except for the deferred tax effects related to fair value re-measurement of available-for-sale investments. As the fair value re-measurement is recognized in other comprehensive income, deferred tax is also recognized in the other comprehensive income and subsequently reclassified to the income statement together with the gain or loss on derecognition.

(n) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Own shares held by the Bank are recognized as a deduction in equity until they are cancelled or resold. When such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity.

Dividends on ordinary shares are recognized in equity in the period in which they are approved by the Bank's general meeting of shareholders. Dividends for the year that are proposed or declared after the statement of financial position date are disclosed in the subsequent events note.

(o) Subsequent Events

The effects of events which occurred between the statement of financial position date and the date when the financial statements were authorized for issue are reflected in the financial statements in the event that these events provide further evidence of conditions which existed at the statement of financial position date.

Where significant events occur subsequent to the statement of financial position date prior to authorizing the financial statements for issue which are indicative of conditions which arose subsequent to the statement of financial position date, the effects of these events are disclosed but do not result in adjustments in the financial statements.

(p) Key Bank's management judgments and estimates

The presentation of financial statements in conformity with IFRS requires management of the Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the reporting date and the reported amounts of revenues and expenses during the reporting period. These estimates, which specifically relate to the impairment of financial assets and provisions arising from the provided financial guarantees, are based on the information available as of the date of preparation of the financial statements and actual results could differ from those estimates.

Impairment losses on loans to customers and provisions for financial guarantees

Management uses estimates based on historical loss experience for assets and financial guarantees with credit risk characteristics similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Should the estimated percentages of the impairment provisions divert from the current management estimate by +/-1%, the impairment loss is to be estimated CZK 43 million higher/lower.

3/ Additional information to statement of financial position and income statement items

3.1. Interest income

CZKm	2016	2015
Interest income on loans and advances to banks	7	10
Interest income on loans and advances to customers	151	217
Interest on loans granted to the government institutions	178	238
Interest on debt securities	312	365
- held for trading	1	1
- designated at fair value through profit or loss	28	36
- available for sale	157	177
- held to maturity	126	151
Interest income	**648**	**830**
Interest on short sales	2	-
Interest on amounts due to banks	(173)	(234)
Interest on deposits due to customers	(8)	(11)
Interest on deposits from government institutions	(49)	(74)
Interest from unwinding discounts on provisions (Note 3.6)	(49)	(54)
Interest expenses	**(277)**	**(373)**
Net interest income	**371**	**457**

Interest income includes CZK 138 million (2015: CZK 191 million) of interest income on impaired financial assets.

3.2. Fee and commission income

CZKm	2016	2015
Fees from financial guarantees	246	317
Credit related fees and commissions	32	33
Fees and commissions from payment transactions	45	38
Fee and commission income	**323**	**388**
Fee and commission expense from trading activities	(2)	(3)
Fee and commission expense	**(2)**	**(3)**
Net fee and commission income	**321**	**385**

3.3. Gains and losses from financial operations

CZKm	2016	2015
Gains and (losses) on securities	22	45
- available for sale	34	46
- amounts reclassified from other comprehensive income on disposal	34	46
- changes in fair value of securities held for trading	6	20
- changes in fair value of securities designated at fair value through profit or loss	(17)	(21)
- gain on revaluation of short sales	(1)	-
Net gains/ (losses) on derivatives held for trading	(23)	(80)
Net gains/ (losses) on hedging derivatives	6	1
Exchange differences (including exchange differences on available for sale and held to maturity debt securities)	2	68
Total income and expenses on financial operations	**7**	**34**

Net gains/ (losses) on hedging derivatives are due to high hedge accounting effectiveness almost fully compensated in the income statement in lines "Exchange differences" in case of the foreign currency risk hedging and in "Interest income" and "Interest expense" in case of interest rate risk hedging. The overall accounting hedge ineffectiveness amounts to CZK 4 million in 2016 (2015: CZK 1 million).

3.4. Administrative expenses

CZKm	2016	2015
Wages, salaries and bonuses	(183)	(177)
Social security costs	(52)	(51)
of which: state pension scheme contributions	(36)	(35)
Total personnel expenses	**235**	**228**
General administrative expenses	(116)	(112)
Total administrative expenses	**(351)**	**(340)**

Wages, salaries and key management compensations:

CZKm	2016	2015
Wages and salaries of the Bank's employees	(111)	(111)
Key management personnel compensation	(56)	(50)
- wages and salaries of the Bank's management	(29)	(28)
- compensations to Board of Directors members	(25)	(20)
- compensations to Supervisory Board members	(1)	(1)
- compensation to Audit Committee members	(1)	(1)
Other employees' expenses	(9)	(9)
Social fund expenditures	(7)	(7)
Total wages, salaries and bonuses	**(183)**	**(177)**

Staff Analysis

	2016	2015
Number of members of the Board of Directors	5	5
Number of members of the Supervisory Board	9	8
Number of members of the Audit Committee	3	3
Average number of the Bank's management	18	17
Average number of Bank's employees (excl. above listed)	192	192

Other administrative expenses comprise:

CZKm	2016	2015
General administrative expenses	(73)	(69)
Rental charges	(6)	(5)
Audit, legal, tax and other professional services	(6)	(5)
Depreciation and amortization	(31)	(33)
Total other administrative expenses	**(116)**	**(112)**

3.5. Increase in loan impairment and write-offs

Overall charge for the loan impairment can be analyzed as follows:

31 December 2016

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions/Disposals to loan impairment allowances	(93)	31	(62)
Receivables written-off during the year not fully provided for	-	-	-
Additions to allowances to other assets	1	-	1
Total increase in loan impairment allowances and write-offs	**(92)**	**31**	**(61)**

31 December 2015

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions/Disposals to loan impairment allowances	(124)	9	(115)
Receivables written-off during the year not fully provided for	-	-	-
Additions to allowances to other assets	(1)	-	(1)
Total increase in loan impairment allowances and write-offs	**(125)**	**9**	**(116)**

Reconciliation of the allowance account for impairment:

Year ended 31 December 2016

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2016	**1,808**	**98**	**1,906**
Additions/Disposals to impairment allowances	93	(31)	62
Use of the allowances for write-offs	(104)	-	(104)
Balance at 31 December 2016	**1,797**	**67**	**1,864**

Year ended 31 December 2015

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2015	**1,771**	**107**	**1,878**
Additions/Disposals to impairment allowances	124	(9)	115
Use of the allowances for write-offs	(87)	-	(87)
Balance at 31 December 2015	**1,808**	**98**	**1,906**

3.6. Provisions for guarantees and other provisions

The balance of provisions for guarantees and other provisions comprises:

CZKm	31 December 2016	31 December 2015
Provisions for guarantees (Note 3.22)	3,132	2,557
Provisions for loan commitments (Note 3.22)	1	2
Other provisions	32	565
Total provisions	**3,165**	**3,124**

Reconciliation of the provisions for guarantees and other provisions:

CZKm	2016	2015
Balance at 1 January	3,124	2,909
Increase/ (decrease) in provisions for guarantees and loan commitments	525	21
Increase/ (decrease) in other provisions	(533)	140
Interest expense from unwinding discounts (Note 3.1)	49	54
Balance at 31 December	**3,165**	**3,124**

In 2016, a new Increase/ (decrease) in other provisions row was introduced to differentiate between provisions connected with guarantees and loans and other provisions.

In 2016, it consisted of:

- A provision for the annual contribution to the Crisis Fund of CZK 58 million, of which CZK 28 million was created for the contribution paid in 2016 (as at 31 December 2015: CZK 110 million). Together with the payment to the Crisis Fund a provision of CZK 138 million (31 December 2015: CZK 0 million) was used. The rest (CZK 30 million) will be used as a contribution for 2017 based on the actual amount stated by the CNB.
- A provision for litigation of CZK 14 million (31 December 2015: CZK 455 million) and the release of a provision for litigation of CZK 467 million connected with MISORA HOLDINGS LIMITED, based on a decision of the Municipal Court in Prague.

The Bank used resources obtained from the release of MISORA HOLDINGS LIMITED's provision for the partial compensation of its risk coverage fund which provides sufficient space for new business activities in the following years. This operation does not lead to a change of the portfolio's total risk coverage size.

3.7. Income taxes

CZKm	2016	2015
Profit before income tax	159	262
Theoretical tax calculated at a statutory income tax rate 2016: 19% (2015: 19%)	30	50
Non-taxable income from securities –permanent difference	(1)	(4)
Effect of non-recognized contingent deferred tax asset	110	24
Other permanent items	-	-
Income tax expense as reported in income statement	139	70
- current	37	97
- deferred	102	(27)
Income tax paid during the year	73	159
Current income tax assets at 31 December	36	62
Current income tax liabilities at 31 December	-	-
Effective tax rate	**87%**	**27%**

Deferred taxation

The recognized deferred tax can be analyzed as follows:

CZKm	31 December 2016	31 December 2015
Other provisions	13	115
Deferred tax recognized in other comprehensive income for revaluation of available for sale securities	(142)	(150)
Total deferred tax	**(129)**	**(35)**

CZKm	31 December 2016	31 December 2015
Deferred tax reported in the statement of financial position		
- to be recovered after more than 12 months	-	87
- to be recovered within 12 months	13	28
Deferred tax recognized in other comprehensive income for revaluation of available for sale securities		
- to be recovered within 12 months	(142)	(150)
Total deferred tax	**(129)**	**(35)**

Potential deferred tax asset of CZK 403 million as at 31 December 2016 (2015: CZK 293 million) arising from differences between accounting and tax values of impairment allowances and provisions has not been recognized as it is not probable that this difference will become tax deductible in the foreseeable future.

CZKm	2016	2015
Deferred tax balance at 1 January	(35)	(33)
Movement through income statement	(102)	27
Movement in deferred tax recognized in other comprehensive income for revaluation of available for sale securities	8	(29)
Deferred tax balance at 31 December	**(129)**	**(35)**

The deferred tax is calculated at the statutory income tax rate of 19% (31 December 2015: 19%), which is a statutory income tax rate enacted for the period, when the Bank anticipates realizing the temporary differences.

3.8. Cash and balances with central banks

CZKm	31 December 2016	31 December 2015
Obligatory minimum reserves	-	111
Cash in hand	8	9
Total cash in hand and balances with central banks	**8**	**120**

Obligatory minimum reserves represent mandatory deposits with the Czech National Bank.

3.9. Loans and advances to banks

CZKm	31 December 2016	31 December 2015
Current accounts with other banks	8	67
Included in cash and cash equivalents (Note 3.21.)	8	67
Other amounts due from banks	78	194
Total loans and advances to banks	**86**	**261**

All the amounts due from banks are unimpaired exposures before due date and no provisions are recognized.

3.10. Securities at fair value through profit or loss

CZKm	31 December 2016	31 December 2015
Government bonds – domestic	-	113
Securities held for trading	-	113
Government bonds – domestic	339	350
Government bonds – foreign	190	332
Bonds issued by Czech financial institutions	-	283
Securities designated at fair value through profit or loss	529	965
Total securities at fair value through profit or loss	**529**	**1,078**

3.11. Loans and advances to customers

CZKm	31 December 2016	31 December 2015
Loans to private legal entities and individuals	3,778	4,367
Loans to the Ministry of Finance and other government entities	4,279	5,931
Loans to municipalities	498	665
Gross amounts due from customers	8,555	10,963
Provisions for loans to customers (Note 3.5)	(1,864)	(1,906)
Net amounts due from customers	**6,691**	**9,057**

Loans to the Ministry of Finance represent principally the loans provided in connection with infrastructure programs which were transferred to the Bank from Konsolidační banka Praha in 2000. These programs are principally targeted at funding the construction of the highway network, repairs of international roads, removal of flood damage and water sector investments. The funding of these programs was provided by the European Investment Bank (Note 3.17) and is denominated also in EUR.

Set out below is the currency structure of the outstanding infrastructure loan principal amounts on the side of assets and liabilities (Note 3.17):

	31 December 2016		31 December 2015	
	Assets CZKm	Liabilities CZKm	Assets CZKm	Liabilities CZKm
CZK – principal	1,806	1,806	2,575	2,575
CZK – accrued interest	1	1	1	1
EUR – principal	2,442	2,442	3,313	3,313
EUR – accrued interest	30	30	42	42
Total	**4,279**	**4,279**	**5,931**	**5,931**

The disclosures per classes of the loans and advances to customers are made in the credit risk section in Note 4.1 and reconciliation of changes in the allowance account during the period for each class of the loans and advances to customers is disclosed in Note 3.5.

3.12. Financial assets available for sale

Available for sale (“AFS”) securities comprise debt securities as follows:

CZKm	31 December 2016	31 December 2015
Fixed income debt securities	4,715	4,765
Variable yield debt securities	10,114	10,147
Total debt securities available for sale	**14,829**	**14,912**

All AFS securities as at 31 December 2016 and 2015 were publicly traded on stock exchanges. They are denominated in various currencies and the currency risk is hedged (see Note 4.3).

AFS securities of CZK 862 million (2015: CZK 6,245 million) were pledged as collateral to third parties in sale and repurchase agreements to provide security over the money borrowed. These assets have been reclassified as pledged assets on the face of the statement of financial position as the borrower possessing the collateral has the right to re-pledge it or sell, however also has an obligation to return it.

AFS securities have been issued by the following issuers:

CZKm	31 December 2016	31 December 2015
- Czech state institutions	11,573	11,986
- Czech local government institutions	510	523
- Czech financial institutions	944	993
- Other Czech entities	186	186
- Foreign financial institutions	1,396	1,106
- Other foreign entities	220	118
Total debt securities available for sale	**14,829**	**14,912**

3.13. Financial assets held to maturity

Held to maturity ("HTM") securities have been issued by the following issuers:

CZKm	31 December 2016	31 December 2015
Czech state institutions	5,145	5,188
Total debt securities held to maturity	**5,145**	**5,188**

HTM securities are denominated in various currencies (see also Note 4.3). HTM securities comprise only securities generating fixed income.

HTM securities of CZK 0 million (2015: CZK 917 million) were pledged as collateral to third parties in sale and repurchase agreements to provide security over the money borrowed. These assets have been reclassified as pledged assets on the face of the statement of financial position as the borrower possessing the collateral has the right to re-pledge it or sell, however he also has an obligation to return it.

3.14. Other assets

CZKm	31 December 2016	31 December 2015
Financial assets		
Accrued income	37	41
Non-financial assets		
Prepaid expenses	12	12
Other	21	19
Total other assets, gross	70	72
Impairment provisions	(8)	(8)
Total other assets, net	**62**	**64**

3.15. Investments in associate

The financial statements include an at equity measured investment in associate, MUFIS a.s., with its registered office address at Jeruzalémská 964/4, Prague 1 ('MUFIS'), key details of which are set out below.

The Bank formed MUFIS, with share capital of CZK 1 million in 1994. In 1995, the Bank disposed of 51 percent of the issued share capital, and holds a 49 percent investment in MUFIS at 31 December 2016 and 2015.

Shareholders' structure	31 December 2016	31 December 2015
ČMZRB	49%	49%
Ministry of Finance	49%	49%
Association of Czech Municipalities	2%	2%

The Bank signed on 27 August 2009 with MUFIS an agreement on cooperation within the area of financing infrastructure projects for municipalities in the Czech Republic. MUFIS is currently involved in providing loans to municipalities and clusters of municipalities through the Joint credit fund created along with ČMZRB.

Activity of Join credit fund was terminated as at 31. 12. 2016 and currently the activity of MUFIS is restrained.

Summary financial information in CZKm	Equity	The Bank's share on equity	Total assets	Profit after tax	The Bank's share on profit
At 31 December 2016 and for the year then ended	221	108	221	(1)	-
At 31 December 2015 and for the year then ended	221	108	223	6	3

3.16. Property, plant and equipmen

CZKm	Land	Buildings	Equipment and fittings	Total
At 1 January 2015				
Acquisition cost	10	308	126	444
Accumulated depreciation	-	(192)	(117)	(309)
Net book value	**10**	**116**	**9**	**135**
Year ended 31 December 2015				
Opening net book value	10	116	9	135
Additions	-	-	20	20
Disposals	-	-	(8)	(8)
Depreciation charge	-	(8)	(8)	(16)
Closing net book value	**10**	**108**	**13**	**131**
At 31 December 2015				
Acquisition cost	10	309	83	402
Accumulated depreciation	-	(201)	(70)	(271)
Net book value	**10**	**108**	**13**	**131**
Year ended 31 December 2016				
Opening net book value	10	108	13	131
Additions	-	1	16	17
Disposals	-	-	(8)	(8)
Depreciation charge	-	(8)	(8)	(16)
Closing net book value	**10**	**101**	**13**	**124**
At 31 December 2016				
Acquisition cost	10	309	83	402
Accumulated depreciation	-	(208)	(70)	(278)
Net book value	**10**	**101**	**13**	**124**

3.17. Deposits from bank

CZKm	31 December 2016	31 December 2015
Due to other banks	5,672	7,677
Repo operations with other banks	863	1,823
Received term deposits from other banks	314	242
Amounts due to banks	**6,849**	**9,742**

Amounts due to other banks include principally the payables to the development banks (European Investment Bank, Kreditanstalt für Wiederaufbau, Nordic Investment Bank and Council of Europe Development Bank) of CZK 5,672 million at 31 December 2016 (31 December 2015: CZK 7,677 million), majority of which represents a funding for infrastructure loans described in Note 3.11.

3.18. Deposits from customers

Amounts due to customers, by type of deposit, comprise:

CZKm	31 December 2016	31 December 2015
Current accounts	1,467	4,020
Term deposits	4,855	2,456
Loans received	44	44
Guarantee deposits	2,639	2,513
Other payables to clients	2,258	2,673
Total	**11,263**	**11,706**

Amounts due to customers, by type of customer, comprise:

CZKm	31 December 2016	31 December 2015
Amounts due to state institutions	5,899	5,830
Amounts due to municipalities	62	57
Amounts due to other customers	5,302	5,819
Total amounts due to customers	**11,263**	**11,706**

The 'Amounts due to state institutions' line includes, inter alia, payables comprising funding and funds to cover risks attached to the guarantee support programs provided by the Bank (Note 2 d and 2 j):

CZKm	31 December 2016	31 December 2015
Funding from the providers of the individual support programs not yet returned	2,720	3,429
Funds deposited by the program partners to cover risks attached to providing the financial guarantees*	2,011	2,659

*Risk coverage funds for programs Panel and Nový Panel in the amount of CZK 969 million (2015: CZK 975 million) are booked in off balance.

3.19. Other liabilities

CZKm	31 December 2016	31 December 2015
Payable to employees	32	33
Deferred income	460	637
- financial guarantees premium deferred income	440	612
- other deferred income	20	25
Accrued expenses (financial liability)	39	40
Amount payable to Ministry for Regional Development in respect to intermediation of the support program (financial liability)	179	190
Other	23	381
Total accruals and other liabilities	**733**	**1,281**

3.20. Equity and profit allocation

Share capital

		31 December 2016		31 December 2015	
	Nominal value of 1 share (CZKm)	Number of shares (pcs.)	Value of shares (CZKm)	Number of shares (pcs.)	Value of shares (CZKm)
Share capital	239 500	10 988	2,632	8 900	2,132

On 1 November 2016, the sole shareholder of the Bank acting within the scope of the general meeting decided to increase the registered capital of Českomoravská záruční a rozvojová banka, a.s. by CZK 500 million. To increase the registered capital, a total of 2 088 ordinary registered book-entry shares, each in the value of CZK 239 500, were issued. The shares were underwritten by a monetary contribution. The shares are registered and issued in book-entry form. All issued shares are fully paid.

Shares owned by the Czech Republic are recorded by Central Securities Depository Prague on asset accounts of Ministry of Industry and Trade, Ministry of Regional Development and Ministry of Finance.

The Bank's Shareholders as of 31 December 2016 and 2015 can by analyzed as follows:

	2016	2015
Shareholder	%	%
Czech Republic	100.000	100.000
Total	**100.000**	**100.000**

Evidence of the Czech state's shares by Central Securities Depository Prague on Ministries' asset accounts

	2016	2015
	%	%
Ministry of Industry and Trade	33.528	33.528
Ministry of Regional Development	33.528	33.528
Ministry of Finance	32.944	32.944
Total	**100,000**	**100,000**

Profit Allocation

The statutory net profit of the Bank as recognized in accordance with Czech accounting standards for the year ended 31 December 2016 is proposed to be allocated and net profit for 2015 of the Bank was allocated as follows:

CZKm	2016	2015
Allocated to retained earnings	9	3
Other funds created from the profit*	11	189
Net profit per statutory financial statements	**20**	**192**

*Based on the decision of the General Meeting a Fund of programs support was created.

Revaluation reserve

The revaluation reserve shows the effects from the fair value measurement of available for sale securities after deduction of deferred taxes. No gains or losses other than foreign exchange are recognized in the income statement until the asset has been disposed or impaired.

Retained earnings and statutory and other reserves

Retained earnings consist of undistributed profits from previous years. Statutory reserve consists of CZK 800 million provided by the Czech State, which has to be set aside in accordance with national law, internally allocated revenue reserve of CZK 350 million and other funds created from the profit (Fund of programs support) in the amount of CZK 189 million.

3.21. Cash and cash equivalents

CZKm	31 December 2016	31 December 2015
Cash and balances with central banks (Note 3.8.)	8	120
Loans and advances to banks (Note 3.9.)	8	67
Total	**16**	**187**

Cash and cash equivalents comprise balances with less than three months' original maturity, including cash in hand, deposits held at call with banks and other short-term highly liquid investments.

3.22. Financial guarantees and loan commitments

Commitments to extend loans and financial guarantees for loans to third parties expose the Bank to credit risk and loss in the event that the client fails to comply with contractual conditions.

CZKm	31 December 2016	31 December 2015
Total issued financial guarantees	18,922	19,926
Loan commitments issued to clients	203	514
Total financial guarantees and loan commitments	**19,125**	**20,440**

In conducting repo and reverse repo transactions, the Bank uses government bonds. Payables from repo transactions are included in amounts due to banks (Note 3.17). The Bank does not record any securities received as a collateral as no loans were granted in reverse repo operations as at 31 December 2016 and 31 December 2015.

3.23. Related party disclosures

Related parties of the Bank comprise:

1/ The Czech state. Dividends allocations are described in Note 3.20 and income taxes in Note 3.7.
2/ The associated undertaking MUFIS;
3/ Key management personnel (being defined as Board of Directors, Supervisory Board and Audit Committee) – for the detail of the expenses see Note 3.4; and
4/ Entities controlled by the same controlling entity, i.e. by the Czech state.

The balances from related-party transactions with the Czech state and entities controlled by the same controlling entity (in the table below - "Other related parties") at the period-end date, related expense and income for the year (except for the income taxes and dividends) and off-balance sheet exposures are as follows:

CZKm	31 December 2016	31 December 2015
Assets	**22,011**	**24,491**
Czech state	21,355	23,568
Associates	1	1
Key management	-	-
Other related parties	655	922
Liabilities	**7,822**	**6,050**
Czech state	5,113	5,470
Associates	220	208
Key management	13	12
Other related parties	2,476	360
Revenues	**561**	**651**
Czech state	473	552
Associates	-	-
Key management	-	-
Other related parties	88	99
Expenses	**34**	**33**
Czech state	5	12
Associates	-	-
Key management	27	21
Other related parties	2	-
Collaterals received under reverse repo transactions and other off-balance sheet liabilities in the normal course of business	**1,665**	**1,689**
Czech state	690	707
Other related parties	975	982

In the opinion of management all transactions entered into with related parties were made in the ordinary course of business on substantially the same terms and conditions, including interest rates, as those prevailing at the same time for comparable transactions with other customers, and did not involve higher than normal credit risk or present other unfavorable features. These include current accounts, loans, deposits and securities issued by these entities and provided collaterals and loan commitments.

In PANEL guarantee program the Bank receives from Státní fond rozvoje bydlení ("SFRB") a fee of 1.3% p.a. of the guaranteed balance amount which is included in Fee and commission income of CZK 44 million (2015: 51 million).

Revenues from the Czech state include also interest income (see Note 3.1) from the infrastructure loans taken over from the Ministry of Finance. For details of the transaction see Note 3.11.

Terms and conditions of the related party transactions - average effective interest rates

The table below provides average interest rates of significant items of related parties assets and liabilities as of 31 December 2016 and 2015.

	31 December 2016	31 December 2015
Assets		
Amounts due from banks	0.05%	0.06%
Loans to customers	3.22%	3.23%
Available for sale securities	1.27%	1.54%
Securities at fair value through profit or loss	5.00%	4.39%
Securities held to maturity	3.61%	4.58%
Liabilities		
Amounts due to banks	0.08%	0.04%
Amounts due to customers	0.03%	0.04%
Repo operations with the Ministry of Finance	0.04%	0.02%

4/ Risk management and financial instruments

4.1. Credit risk

4.1.1. Risk management method

Credit rating of amounts due from customers and banks

The credit rating of the enterprises that are small and medium-sized businesses, municipalities, water management enterprises, housing associations and associations of owners of housing units, and non-profit organizations is undertaken in accordance with the Bank's internal regulations and involves assessing the borrower's creditworthiness on the basis of an analysis of economic and other aspects. The assessment of other than economic aspects involves analyzing external and internal factors that impact the client's activities and operations. The economic assessment focuses on undertaking a financial analysis of economic indicators and additional information. Creditworthiness is evaluated in relation to each transaction that carries an element of credit risk; credit risk exposure and the ratings are periodically assessed over the whole life of the loan transaction. Credit risk is expressed by assigning the borrower the relevant risk category. Credit risk exposure involved in a specific transaction is controlled by establishing contractual conditions and obtaining collateral in support of the transaction.

The monitoring of rating and credit risk involves assessing the following criteria (at minimum):

- Current financial and economic situation of the clients;
- Compliance with contractual terms, specifically reviews of the repayments of loan principal and interest amounts, payment of the fee for the provision of a guarantee, contractual penalties and charges, provision of information to the Bank, and balances on the client's bank accounts;
- Restructuring;
- External factors, primarily economic, political and legal;
- Loan analysts quarterly monitor the development of selected data and information for the monitoring of all clients as part of a client's financial analysis;
- Staff of the Risky Transactions Department monitor the records of clients in bankruptcy, settlement and liquidation on an ongoing basis, with regular weekly checks;
- Staff of business units monitor, on a monthly basis, the summary of clients for which the central loan register indicates that they have past due receivables.

Measuring credit risk of the portfolio

The Bank uses the following techniques to measure risks inherent in the loan and guarantee portfolio:

The method of quantified losses on the portfolio of loans and guarantees exposures compares the total quantified losses of doubtful and loss receivables with the redemption of these exposures. The quantification of losses also reflects the current balances of substandard exposures adjusted by an empirical and well-established coefficient which represents an estimate of the default rate of exposures in this category.

The weighted risk exposure method compares the weighted risk exposure with the original contractual amount of the loans (the balance of the actual loan draw-down) and guarantees. The weighted risk exposure consists of the sum of recorded provisions, the sum of receivables written-off, the sum of outstanding principal, the sum of outstanding interest and the sum of outstanding contractual penalties on client accounts, segmented by individual years of the portfolio's duration.

The risk category method compares quantified losses with the original contractual value of the loans or guarantees.

The incurred loss method is derived from calculated probabilities of individually unidentified default on individual internal risk categories described below and loss given default for specified type of exposures (loans, loans granted within the water infrastructure support program and guarantees).

Risk categories

The Bank has risk (internal rating) categories 4 to 10, which are linked to the Czech National Bank's risk categories: standard loans 4, 5 and 6, watch 7, substandard 8, doubtful 9 and loss 10. In 2012 the Bank established internal rating category X9. Clients, which the Bank considers doubtful and which are overdue only 180 days or less, are classified into this category.

Credit enhancement

In the course of its lending and guarantees business, the Bank accepts movable and immovable assets pledged as collateral. This fact is also considered in calculation of the impairment provisions. The Bank also uses various forms of guarantee statements to collateralize its loan receivables.

Movable and immovable asset collateral is recorded in operating records and is valued on the basis of an appraisal prepared by a licensed appraiser (nominal value of collateral). The Bank centrally revalues real estate collateral to market values every two years on the basis of pricing maps prepared by an external agency. Collaterals provided by individuals and legal entities and bills of exchange are recorded in operating records and are valued at estimated values provided by the Bank's internal regulation.

The recoverable value of collateral takes into account both the cost of recovering collateral and the time value of money.

If the borrower's receivable is past due by more than 360 days, the Bank does not attribute any value to the collateral, since the historical evidence proves negligible workouts from such collaterals.

Recovery of Amounts due from borrowers

The Bank recovers due receivables arising from bank guarantees and loans through its internal debt work-out system by using all statutory recovery instruments available according to generally applicable legal regulations. With a view to expediting the recovery process, the Bank has employed an arbitration clause in respect of loan contracts and enforceable notarial and distrained deeds.

Economic sector risk concentrations

The Bank principally monitors risk concentrations in the area of loans issued to small and medium-sized businesses and receivables arising primarily from water management loans. These risks are periodically monitored and reassessed at least on an annual basis. Credit risk limits are approved by the Board of Directors. This concentration translates into the definition of the classes of the loans to customers.

Geographical concentrations

Although the Bank performs its key activities in the Czech Republic, some investments in securities are done also outside of the Czech Republic. For the geographical concentrations see Note 4.1 B.

Risk concentrations

Significant risk concentration is defined by the Bank as a situation, where excessive concentration of exposures against mutually related entities or groups, certain industries, business activities or geographical areas would have significant impact on Bank's performance and stability in the case of negative development.

The Bank primarily monitors risk concentrations in the area of preferential guarantees issued for loans to small and medium-sized businesses and for loans issued on housing units' repairs, preferential loans issued by the Bank to small and medium-sized businesses and loans to entrepreneurs and municipalities for water management projects. Majority of these loans and guarantees is provided in cooperation with the government and given the fact that the state participates on risk in some types of loans and guarantees the Bank's risk is effectively shared and thus limited. The Bank manages its risk concentrations in relation to credit exposure using system of limits for credit risk management. To identify concentration of credit risk the Bank mainly uses methods and procedures that are based on data analysis, which are stored in internal business and accounting systems of the Bank. The Bank does not use any hedging derivatives to eliminate these risks. The risks are periodically monitored.

Credit risk of other financial assets

Generally, in accordance with its internal regulations, the Bank defines eligible financial instruments for its investments. These principally involve deposits, bonds (mortgage bonds, CZK bonds, EUR bonds, and other foreign currency bonds) and derivatives (FX FWD, FX SWAP, CCS, IRS).

Credit assessment of counterparties and issuers involves analyzing the borrower's solvency on the basis of credit ratings published by internationally recognized rating agencies and evaluating economic and other aspects. The solvency of counterparties and issuers is periodically assessed over the whole life of the commercial loan transaction.

4.1.2. Credit risk – quantitative disclosures

aa) Quality of amounts due from customers

Information about the credit quality of financial assets that are neither past due nor impaired

31 December 2016

CZKm Classes of financial assets	Risk category 4, 5	6	7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	57	268	64	7	-	-	22	418
Loans to Czech government entities	4,279	-	-	-	-	-	-	4,279
Loans to municipalities	-	185	-	-	-	-	-	185
Total	**4,336**	**453**	**64**	**7**	**-**	**-**	**22**	**4,882**

31 December 2015

CZKm Classes of financial assets	Risk category 4, 5	6	7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	91	367	90	15	-	-	24	587
Loans to Czech government entities	5,931	-	-	-	-	-	-	5,931
Loans to municipalities	-	242	-	-	-	-	-	242
Total	**6,022**	**609**	**90**	**15**	**-**	**-**	**24**	**6,760**

Analysis of financial assets that are individually determined to be impaired

31 December 2016

CZKm Classes of financial assets	Risk category 7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	795	325	259	1,159	822	3,360
Loans to municipalities	265	34	14	-	-	313
Total	**1,060**	**359**	**273**	**1,159**	**822**	**3,673**

31 December 2015

CZKm Classes of financial assets	Risk category 7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	1,152	425	367	1,135	701	3,780
Loans to municipalities	365	30	28	-	-	423
Total	**1,517**	**455**	**395**	**1,135**	**701**	**4,203**

Analysis by regulatory rating

The loans to clients comprise the following, broken down by regulatory classification:

CZKm	Internal rating	31 December 2016	31 December 2015
Standard	4 – 6	4,770	6,611
Watched	7	1,163	1,650
Substandard	8	368	471
Doubtful	9	273	394
Loss	10	1,981	1,837
Total		**8,555**	**10,963**
Impairment provision for loans to customers (Note 3.5)		(1,864)	(1,906)
Net amounts due from customers		**6,691**	**9,057**

Analysis of provisions by risk category

CZKm		31 December 2016		31 December 2015	
Risk category		Type of provision		Type of provision	
		Individual	Portfolio	Individual	Portfolio
4 – 6	Standard	-	20	-	31
7	Watched	144	16	196	22
8	Sub-standard	93	-	119	-
9	Doubtful	116	-	182	-
10	Loss	1,475	-	1,356	-
Total		**1,828**	**36**	**1,853**	**53**
Total provisions			**1,864**		**1,906**

Analysis by collateral

The loan portfolio comprises the following, broken down by type of collateral:

CZKm	31 December 2016	31 December 2015
Bank guarantees and collateral by reliable guarantors	716	734
Cash collateral	7	10
Real estate collateral	956	1,544
Other loan collateral	58	80
Uncollateralized	6,818	8,595
Total	**8,555**	**10,963**
Impairment provision for loans to customers (Note 3.5)	(1,864)	(1,906)
Net amounts due from customers	**6,691**	**9,057**

Renegotiated loans to customers

CZKm	31 December 2016	31 December 2015
Loans to private legal entities and individuals	174	192

Aging analysis of loans past due which are not classified as individually impaired

As at 31 December 2016 the balance of loans past due which were not classified as individually impaired were CZK 0 million (2015: 0 million).

ab) Quality of guarantees portfolio

31 December 2016 in CZKm

Programs	Risk classification								
	5	6	7	8	X9[1)]	9	10	No risk category*	Total
Guarantees for small and medium sized enterprises provided until 2006	3	5	25	43	39	-	60	-	175
PANEL small portfolio guarantees	-	31	82	4	10	-	4	181	312
PANEL individual investment guarantees	-	847	1,813	249	255	-	3	-	3,167
Other previously provided guarantees	-	-	-	-	-	-	1	-	1
Vadium	-	-	70	1	-	-	-	-	71
Small portfolio guarantees for businessmen since 2007	-	9	46	62	18	3	1	454	593
Small portfolio guarantees without external risk enhancement	36	255	740	254	69	13	19	10,489	11,875
Individual investment and operating guarantees for small and medium sized enterprises since 2007	20	212	1,467	437	478	-	114	-	2,728
Total	**59**	**1,359**	**4,243**	**1,050**	**869**	**16**	**202**	**11,124**	**18,922**

*Portfolio approach

[1)]Category X9 is used by the Bank to designate guarantees where the Bank anticipates delivery of the pay-out call.

31 December 2015 in CZKm

Programs	Risk classification								
	5	6	7	8	X9[1)]	9	10	No risk category*	Total
Guarantees for small and medium sized enterprises provided until 2006	4	10	46	36	52	-	99	-	247
PANEL small portfolio guarantees	-	35	98	11	9	-	4	204	361
PANEL individual investment guarantees	-	936	2,277	366	170	-	23	-	3,772
Other previously provided guarantees	-	-	-	-	-	-	22	-	22
Vadium	-	-	64	-	-	-	-	-	64
Small portfolio guarantees for businessmen since 2007	13	103	337	136	66	-	3	3,405	4,063
Small portfolio guarantees without external risk enhancement	27	214	742	184	82	-	9	6,796	8,054
Individual investment and operating guarantees for small and medium sized enterprises since 2007	18	191	1,861	519	608	-	146	-	3,343
Total	**62**	**1,489**	**5,425**	**1,252**	**987**	**-**	**306**	**10,405**	**19,926**

*Portfolio approach

[1)]Category X9 is used by the Bank to designate guarantees where the Bank anticipates delivery of the pay-out call.

ac) Quality of Securities portfolio

The securities portfolio comprises the following, broken down by rating classification and classes of financial instruments:

31 December 2016

CZKm	AA- to AA+	A- to A+	Lower than A	Total
Securities at fair value through profit or loss	-	529	-	529
Securities available for sale	1,006	12,530	1,293	14,829
Securities held to maturity	-	5,145	-	5,145
Total	**1,006**	**18,204**	**1,293**	**20,503**

31 December 2015

CZKm	AA- to AA+	A- to A+	Lower than A	Total
Securities at fair value through profit or loss	113	965	-	1,078
Securities available for sale	9,628	4,382	902	14,912
Securities held to maturity	2,353	2,835	-	5,188
Total	**12,094**	**8,182**	**902**	**21,178**

ad) Quality of derivatives portfolio

The derivatives portfolio as at 31 December 2016 and 2015 includes established banking counterparties (with external rating equivalent of AA+ to A).

b) Geographical concentration of assets

31 December 2016

Assets

CZKm	Czech Republic	European Union	Total
Cash and balances with central banks	8	-	8
Amounts due from banks	86	-	86
Securities at fair value through profit or loss	339	190	529
Positive fair values of financial derivative transactions	80	-	80
Loans and advances to customers	6,691	-	6,691
Securities available for sale	13,214	1,615	14,829
Securities held to maturity	5,145	-	5,145
Other financial assets	37	-	37
Total financial assets	**25,600**	**1,805**	**27,405**
Non-financial assets	**314**	**-**	**314**
Total	**25,914**	**1,805**	**27,719**

31 December 2015

Assets

CZKm	Czech Republic	European Union	Total
Cash and balances with central banks	120	-	120
Amounts due from banks	261	-	261
Securities at fair value through profit or loss	746	332	1,078
Positive fair values of financial derivative transactions	103	-	103
Loans and advances to customers	9,057	-	9,057
Securities available for sale	13,688	1,224	14,912
Securities held to maturity	5,188	-	5,188
Other financial assets	41	-	41
Total financial assets	**29,204**	**1,556**	**30,760**
Non-financial assets	**347**	**-**	**347**
Total	**29,551**	**1,556**	**31,107**

c) The Bank's maximum credit risk exposure

31 December 2016 in CZKm

		Total exposure		Collateral held
	Assets	Financial guarantees and loan commitments	Total credit exposure	
Cash and balances with central banks	8	-	8	-
Amounts due from banks	86	-	86	-
Securities at fair value through profit or loss	529	-	529	-
Financial derivatives	80	-	80	-
Loans to customers	6,691	-	6,691	1,737
- Loans to private legal entities and individuals	1,981	-	1,981	1,477
- Loans to the Czech government entities	4,279	-	4,279	-
- Loans to municipalities	431	-	431	260
Securities available for sale	14,829	-	14,829	
Securities held to maturity	5,145	-	5,145	
Other financial assets	37	-	37	
Financial guarantees and loan commitments	**-**	**19,125**	**-**	**2,011**
Total financial assets	**27,405**	**19,125**	**46,530**	**3,748**
Non-financial assets	**314**			
Total assets	**27,719**			

31 December 2015 in CZKm

		Total exposure		Collateral held
	Assets	Financial guarantees and loan commitments	Total credit exposure	
Cash and balances with central banks	120	-	120	-
Amounts due from banks	261	-	261	-
Securities at fair value through profit or loss	1,078	-	1,078	-
Financial derivatives	103	-	103	-
Loans to customers	9,057	-	9,057	2,368
- Loans to private legal entities and individuals	2,559	-	2,559	2,022
- Loans to the Czech government entities	5,931	-	5,931	-
- Loans to municipalities	567	-	567	346
Securities available for sale	14,912	-	14,912	-
Securities held to maturity	5,188	-	5,188	-
Other financial assets	41	-	41	-
Financial guarantees and loan commitments	**-**	**20,441**	**-**	**2,659**
Total financial assets	**30,760**	**20,441**	**51,201**	**5,027**
Non-financial assets	**347**			
Total assets	**31,107**			

The maximum credit exposure is presented at carrying values net of any recognized impairment losses. Collaterals held for due from banks represents the fair value of the securities obtained under reverse repo transactions, for loans to customers principally the collateralized mortgages (see Note 4.1.2) and in case of the financial guarantees the current level of funds deposited by the programs partners to cover risks attached to providing of the financial guarantees (see Note 3.18).

4.2. Market risk

4.2.1. Management of the market risk

Characteristics of Market Risks

The principal market risk management strategy is defined in the Bank's internal regulations and in the documents approved by the Board of Directors of the Bank, and primarily provides guidance on the following areas:

- Acceptable degree of market risks;
- Market risk management techniques;
- Set of limits used; and
- Basic requirements regarding the Bank's organizational structure in terms of market risk management, including segregation of duties and information flows.

Description of Transactions Carrying Market Risks

The Bank is exposed to market risks through the acquisition, holding and selling of investment instruments defined in ČMZRB's investment strategy. This risk arises from open positions in interest rates and currencies, but there are no exposures to risk in equities. The Bank does not want to have any open foreign currency trading positions as this strategy is accomplished using of currency forwards and cross-currency swaps, which are concluded with the purpose to close currency positions arising from the purchase of foreign currencies bonds or acceptance of foreign currencies loans. The Bank in certain cases also hedges the interest rate risk related to loans from developing banks.

Market Risk Measurement

The Bank measures interest rate risk using basic techniques (interest rate GAP analysis, duration and elasticity of interest rates) and techniques to calculate capital ratio as set out in Regulation (EU) No 575/2013 of the European Parliament and of the Council.

In addition, the Bank has developed a series of internal limits to restrict its market risk exposure. The interest rate GAP analysis measures interest rate risk inherent in the trading and banking book on a collective basis. Interest rate risk is restricted through limits to net interest rate exposure in each time bucket. Interest rate risk inherent in all bond portfolios is restricted by having a limit in place in respect of the elasticity of the bond portfolio. The Bank undertakes stress testing on a quarterly basis in accordance with Regulation no.163/2014.

Market Risk Management

The Bank's instrument for managing market risks involves the external capital ratio limit and internal limits for interest rate risk and elasticity of the interest rate in respect of the bond portfolio. In addition, the market risk is mitigated through the implementation of an internal capital ratio limit.

Foreign currency risk is prevented by limits set out in Regulation (EU) No 575/2013 of the European Parliament and of the Council.

Interest rate risk limits restrict the size of interest rate GAP in each time bucket of an interest rate GAP analysis in relation to the Bank's capital and are expressed in percentage terms. The limit for elasticity of the interest rate in respect of the bond portfolio restricts the market risk associated with all bond portfolios together with derivatives hedging risk arising from the change in exchange rates when the Bank holds foreign currency bonds.

The Bank's internal capital ratio limit sets out requirements that are more stringent than the external capital ratio limit established by the banking regulator.

4.2.2. Derivates

Trading derivatives

CZKm	31 December 2016 Notional value asset	31 December 2016 Notional value liability	31 December 2015 Notional value asset	31 December 2015 Notional value liability
Interest rate swaps	500	500	500	500
Currency and cross-currency swaps	1,445	1,388	2,091	2,109
Total	**1,945**	**1,888**	**2,591**	**2,609**

CZKm	31 December 2016 Positive fair value	31 December 2016 Negative fair value	31 December 2015 Positive fair value	31 December 2015 Negative fair value
Interest rate swaps	-	46	-	53
Currency swaps	80	47	103	155
Total	**80**	**93**	**103**	**208**

Hedging derivatives

The Bank uses the fair value hedging derivatives to hedge currency risk relating to recognized hedged items, which are securities denominated in foreign currencies (see Notes 3.12 and 4.3).

CZKm	31 December 2016 Notional value asset	31 December 2016 Notional value liability	31 December 2015 Notional value asset	31 December 2015 Notional value liability
Cross currency swaps	144	154	171	182
Total	**144**	**154**	**171**	**182**

CZKm	31 December 2016 Positive fair value	31 December 2016 Negative fair value	31 December 2015 Positive fair value	31 December 2015 Negative fair value
Cross currency swaps	-	29	-	36
Total	**-**	**29**	**-**	**36**

4.3. Foreign currency risk

The Bank's financial position and cash flows are exposed to the risks of changes in exchange rates of common foreign currencies. The Bank monitors its foreign currency positions on a daily basis. In the event that the Bank breaches limits, it undertakes measures as outlined in its internal regulations relating to foreign currency exposure limits.

The table below provides summary information about the Bank's exposure to foreign currency risk. The tables set out foreign currency assets and liabilities at carrying values, analyzed by currency.

The Bank covers its open position by using financial derivatives as can be seen from the tables below and the sensitivity analysis.

31 December 2016

CZKm	CZK	EUR	USD	Total
Cash and balances with central bank	8	-	-	8
Amounts due from banks	82	2	2	86
Securities at fair value through profit or loss	339	190	-	529
Financial derivatives	80	-	-	80
Loans to customers, net	4,218	2,473	-	6,691
Securities available for sale	14,457	278	94	14,829
Securities held to maturity	5,145	-	-	5,145
Other financial assets	37	-	-	37
Total financial assets	**24,366**	**2,943**	**96**	**27,405**
Non-financial assets	**306**	**8**	**-**	**314**
Total assets	**24,672**	**2,951**	**96**	**27,719**
Amounts due to banks	2,618	4,136	95	6,849
Amounts due to customers	11,237	26	-	11,263
Financial derivatives	122	-	-	122
Other financial liabilities	218	-	-	218
Total financial liabilities	**14,195**	**4,162**	**95**	**18,452**
Non-financial liabilities and equity	**9,266**	**-**	**1**	**9,267**
Total liabilities and equity	**23,461**	**4,162**	**96**	**27,719**
Statement of financial position net	1,211	(1,211)	-	-
Off-balance sheet derivatives notional position, net	-	1,282	-	-
Net position	**1,211**	**71**	**-**	**-**

31 December 2015

CZKm	CZK	EUR	USD	Total
Cash and balances with central bank	120	-	-	120
Amounts due from banks	197	64	-	261
Securities at fair value through profit or loss	463	332	283	1,078
Financial derivatives	103	-	-	103
Loans to customers, net	5,701	3,356	-	9,097
Securities available for sale	14,912	-	-	14,912
Securities held to maturity	5,188	-	-	5,188
Other financial assets	41	-	-	41
Total financial assets	**26,725**	**3,752**	**283**	**30,760**
Non-financial assets	**347**	**-**	**-**	**347**
Total assets	**27,072**	**3,752**	**283**	**31,107**
Amounts due to banks	4,585	5,157	-	9,742
Amounts due to customers	11,655	51	-	11,706
Financial derivatives	244	-	-	244
Other financial liabilities	230	-	-	230
Total financial liabilities	**16,714**	**5,208**	**-**	**21,922**
Non-financial liabilities and equity	**9,185**	**-**	**-**	**9,185**
Total liabilities and equity	**25,899**	**5,208**	**-**	**31,107**
Statement of financial position net	1,173	(1,456)	283	-
Off-balance sheet derivatives notional position, net	-	1,503	(273)	-
Net position	**1,173**	**47**	**10**	**-**

Foreign exchange rates sensitivity analysis

Set out below is a sensitivity analysis to foreign currency risk. The statement of financial position items in foreign currencies were tested in respect of the upward movement of a foreign exchange rate by 10% (a 10% appreciation of the currencies would have an equal and opposite effect). The open position in EUR and USD currencies is hedged using derivatives. The hedging instruments almost fully counter-balance the open position (see tables above) and therefore also the income statement and equity impact of the movements in foreign exchange rates is not significant as of the statement of financial position date and also during the year. The table below summarizes the sensitivities in CZK in comparison only to CZK/EUR exchange rates valid as of 31 December 2016 or 2015 as EUR was the only significant currency in which the Bank had open position as at that date (for open position amounts see above).

	2016 CZKm	**2015 CZKm**
Sensitivity to changes in EUR rates		
Expected rate fluctuation, %	10%	10%
Open position	71	47
Effect on profit and loss	(22)	5
Effect on equity	28	-

4.4. Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument indicates to what extent it is exposed to interest rate risk.

The table below provides information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market interest rate before maturity, the next repricing date. Those assets and liabilities that do not have contractual maturity or a repricing date were grouped in the 'non-specified' category.

The Bank has a significant portion of amounts due to customers which are not interest bearing instruments. These comprise part of state deposits and risk funds (see Note 3.18). These liabilities are presented as liabilities with non-specified interest rate sensitivity.

Impaired loans are carried on a non-accrual basis and presented as items with non-specified interest rate sensitivity.

31 December 2016

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Non-specified CZKm	Total CZKm
Cash and balances with central bank	-	-	-	-	8	8
Amounts due from banks	86	-	-	-	-	86
Securities at fair value through profit or loss	-	15	514	-	-	529
Financial derivatives	-	-	-	-	80	80
Loans to customers, net	767	1,241	3,272	639	772	6,691
Securities available for sale	8	785	3,760	10,276	-	14,829
Securities held to maturity	-	494	1,796	2,855	-	5,145
Other financial assets	-	-	-	-	37	37
Total financial assets	**861**	**2,535**	**9,342**	**13,770**	**897**	**27,405**
Non-financial assets	**-**	**-**	**-**	**-**	**314**	**314**
Total	**861**	**2,535**	**9,342**	**13,770**	**1,211**	**27,719**
Amounts due to banks	2,352	1,162	2,917	437	(19)	6,849
Amounts due to customers	8,950	2	-	-	2,311	11,263
Financial derivatives	-	-	-	-	122	122
Other financial liabilities	-	-	-	-	218	218
Total financial liabilities	**11,302**	**1,164**	**2,917**	**437**	**2,632**	**18,452**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**9,267**	**9,267**
Total	**11,302**	**1,164**	**2,917**	**437**	**11,899**	**27,719**
Net interest position	**(10,441)**	**1,371**	**6,425**	**13,333**	**(10,688)**	**-**

31 December 2015

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Non-specified CZKm	Total CZKm
Cash and balances with central bank	111	-	-	-	9	120
Amounts due from banks	261	-	-	-	-	261
Securities at fair value through profit or loss	139	299	528	112	-	1,078
Financial derivatives	-	-	-	-	103	103
Loans to customers, net	792	1,308	5,054	1,007	896	9,057
Securities available for sale	5	317	3,625	10,965	-	14,912
Securities held to maturity	-	-	2,076	3,112	-	5,188
Other financial assets	-	-	-	-	41	41
Total financial assets	**1,308**	**1,924**	**11,283**	**15,196**	**1,049**	**30,760**
Non-financial assets	**-**	**-**	**-**	**-**	**347**	**347**
Total	**1,308**	**1,924**	**11,283**	**15,196**	**1,396**	**31,107**
Amounts due to banks	3,205	1,203	4,519	825	(10)	9,742
Amounts due to customers	8,120	857	-	-	2,729	11,706
Financial derivatives	-	-	-	-	244	244
Other financial liabilities	-	-	-	-	230	230
Total financial liabilities	**11,325**	**2,060**	**4,519**	**825**	**3,193**	**21,922**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**9,185**	**9,185**
Total	**11,325**	**2,060**	**4,519**	**825**	**12,378**	**31,107**
Net interest position	**(10,017)**	**(136)**	**6,764**	**14,371**	**(10,982)**	**-**

Interest rate sensitivity analysis

Statement of financial position items sensitive to interest rates were analyzed under the 2% expected parallel increase in interest rates. The Bank modelled 8 scenarios for possible movements of interest rates as the benchmark; the most probable alternative of 2% parallel shift was selected for reporting purposes. The impact on profit and loss and equity (in the case of available-for-sale securities) is outlined below.

Statement of financial position item	31 December 2016 Sensitivity/Impact	31 December 2015 Sensitivity/Impact	Comment
Assets			
Loans to customers	(86)	(123)	
Loans to banks	-	-	
Held to maturity securities	-	-	
			Only fixed interest rates securities in the portfolio
Available for sale securities	71	214	
Impact on equity reserve			
Available for sale securities	218	277	
Impact on profit and loss			
Financial derivatives	(76)	(129)	
Liabilities			
Due to banks	253	366	
Due to customers	5	8	
Financial derivatives	78	132	

4.5. Liquidity risk

Liquidity risk is the risk that the Bank will lose its ability to meet its financial obligations as they fall due or that it will not be able to fund its assets. Liquidity risk may result from a temporary payment insolvency and low liquidity of the market with financial instruments, which makes it impossible to quickly close out positions thereby limiting access to funding. The basic liquidity management tool involves the record-keeping and planning of the Bank's cash flows. In support of liquidity management, the Bank uses two mechanisms - payment notices and price setting. The liquidity management strategy is established and implemented through the preparation of a 'Liquidity Scenario' and 'Emergency Plan for Events Jeopardising the Bank's Liquidity'. The Bank's liquidity position is monitored through the liquidity reserve limit in relation to the value of adjusted weighted risk exposure.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs, guarantees, margins and settlement of derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

The table below analyses assets and liabilities of the Bank into relevant maturity groupings based upon the remaining maturity period as of the period-end date.

As the main depositors of the Bank are state institutions (Ministry of Finance etc.) the current accounts of the Bank are presented as being repayable on demand because these funds can be withdrawn upon demand. However these deposits represent specific financing granted, e.g. funding for state approved programs and therefore their withdrawal is not likely in large volume upon demand.

The Bank has a significant portion of amounts due to customers which are held for an undefined amount of time to finance individual support programs. These comprise part of state deposits and risk funds (see Note 3.18). These liabilities are presented as liabilities with undefined maturity.

31 December 2016

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Maturity undefined CZKm	Total CZKm
Cash and balances with central bank	5	-	-	-	3	8
Amounts due from banks	8	-	-	-	78	86
Securities at fair value through profit or loss	-	15	514	-	-	529
Financial derivatives	-	-	56	24	-	80
Loans to customers, net	1,172	1,396	3,626	497	-	6,691
Securities available for sale	8	785	3,760	10,276	-	14,829
Securities held to maturity	-	494	1,796	2,855	-	5,145
Other financial assets	23	-	-	-	14	37
Total financial assets	**1,216**	**2,690**	**9,752**	**13,652**	**95**	**27,405**
Non-financial assets	**51**	**5**	**1**	**-**	**257**	**314**
Total	**1,267**	**2,695**	**9,753**	**13,652**	**352**	**27,719**
Amounts due to banks	1,967	1,196	3,231	455	-	6,849
Amounts due to customers	6,343	2,641	42	2,237	-	11,263
Financial derivatives	-	-	101	21	-	122
Other financial liabilities	-	-	-	-	218	218
Total financial liabilities	**8,310**	**3,837**	**3,374**	**2,713**	**218**	**18,452**
Non-financial liabilities and equity	**283**	**1,070**	**1,063**	**1,208**	**5,643**	**9,267**
Total	**8,593**	**4,907**	**4,437**	**3,921**	**5,861**	**27,719**
Net liquidity exposure	**(7,326)**	**(2,212)**	**5,316**	**9,731**	**(5,509)**	**-**

31 December 2015

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Maturity undefined CZKm	Total CZKm
Cash and balances with central bank	117	-	-	-	3	120
Amounts due from banks	67	-	-	-	194	261
Securities at fair value through profit or loss	139	299	528	112	-	1,078
Financial derivatives	-	-	27	76	-	103
Loans to customers, net	1,197	1,490	5,521	849	-	9,057
Securities available for sale	5	317	3,625	10,965	-	14,912
Securities held to maturity	-	-	2,076	3,112	-	5,188
Other financial assets	29	-	-	-	12	41
Total financial assets	**1,554**	**2,106**	**11,777**	**15,114**	**209**	**30,760**
Non-financial assets	**14**	**6**	**1**	**-**	**326**	**347**
Total	**1,568**	**2,112**	**11,778**	**15,114**	**535**	**31,107**
Amounts due to banks	2,869	1,236	4,762	875	-	9,742
Amounts due to customers	5,967	3,050	44	2,645	-	11,706
Financial derivatives	15	87	79	63	-	244
Other financial liabilities	-	-	-	-	230	230
Total financial liabilities	**8,851**	**4,373**	**4,885**	**3,583**	**230**	**21,922**
Non-financial liabilities and equity	**674**	**757**	**819**	**1,788**	**5,147**	**9,185**
Total	**9,525**	**5,130**	**5,704**	**5,371**	**5,377**	**31,107**
Net liquidity exposure	**(7,957)**	**(3,018)**	**6,074**	**9,743**	**(4,842)**	**-**

Contractual liquidity of the main non-derivative financial liabilities at amortized cost and derivatives – undiscounted basis

a/ Amounts due to banks and customers

31 December 2016

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	1,938	1,344	3,398	525	7,205
Amounts due to customers	8,579	3	1,712	972	11,266

31 December 2015

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	2,863	1,441	5,323	1,097	10,724
Amounts due to customers	8,337	869	1,929	572	11,707

b/ Derivatives settled on a net basis

The table below analyses the Bank's derivative financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the period-end date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted net cash flows.

31 December 2016

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	-	(12)	(35)	-	(47)

31 December 2015

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	-	(13)	(39)	(3)	(55)

c/ Derivatives settled on a gross basis

The Bank's derivatives that will be settled on a gross basis comprise of foreign exchange derivatives: currency forward, currency swaps and cross currency interest rate swaps.

The table below analyses the Bank's derivative financial liabilities that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the period-end date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

4.6. Operational risk

31 December 2016

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Cross-currency swaps:					
Cash inflows	84	283	1,038	229	1,634
Cash outflows	(74)	(295)	(1,053)	(221)	(1,643)

31 December 2015

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Cross-currency swaps:					
Cash inflows	211	483	1,275	377	2,346
Cash outflows	(214)	(583)	(1,290)	(362)	(2,449)

The Bank defines operational risk as the risk of loss arising from human errors, the inappropriateness or failure of internal processes, failures of systems or the risk of loss resulting from external events.

The system of the Bank's operational risk management is built around the following four cornerstones:

- Strategy (clear vision, management attitude, culture);
- Organization (Board of Directors, Assets and Liabilities Management Committee, internal audit, operational risk management coordinator, and the Bank's departments);
- Processes (identification, evaluation, countermeasures, monitoring and reporting); and
- Infrastructure (system, source of information, data collection and communication).

Identification of Operational Risk

The Bank identifies individual operational risks in all of its departments and categorizes them according to the underlying cause (human error, internal process, information system, external factor). Responsibility for identifying operational risks primarily rests with the head of the department where the risk originates (via a self-evaluation form). Collection of information from individual departments and its processing is within the remit of the coordinator. The Bank identifies and records each risk to which it is exposed, even a risk that is no longer treated as a risk due to the countermeasures that are currently being implemented.

Evaluation of Operational Risk

Operational risk is evaluated in terms of the likelihood of its occurrence (graded one to five) and the significance of impact if it materializes (graded one to five). The Bank has opted for a qualitative approach to evaluating the risk which better meets its needs and better reflects the situation within the Bank. The evaluation is based on a reasonable estimate and uses scores to assess the likelihood of the occurrence and the significance of impact. Following the evaluation, individual risks are rated according to their overall significance (risk profile) into the following three levels:

- Low (ideal risk profile where the Bank only checks the effectiveness of the existing measures);
- Medium (the risk is acceptable only if the implementation of an appropriate countermeasure to mitigate the risk is too costly); and
- High (the risk is not acceptable, additional countermeasures need to be put in place and the risk mitigated).

Countermeasures

Responsibility for the implementation of an appropriate countermeasure against operational risks rests within the department where the risk originates (mitigation of the likelihood of the occurrence of operational risk or its impact on the Bank).

Monitoring and Reporting

The basic tool for monitoring is the database of incidents and a report on operational risk management within the Bank. These activities result in a risk profile of the Bank. Operational risk events include all events that have a direct impact on the Bank's profit or loss according to the Bank's activities during which the event occurred.

4.7. Capital management

The Bank has identified the following risks which should be covered entirely or partially by capital: market risks, interest rate risk of the banking book, credit risk and concentration risk, liquidity risk and operational risk.

The principal objectives of the Bank in managing capital risks are as follows:

- Quantification of risks in the form of economic capital which is needed to cover potential losses arising from these risks;
- Comparison of capital requirements with capital resources;
- Management of capital resources with respect to current and future risks;
- Determination of the maximum acceptable degree of risks with respect to available capital resources;
- Monitoring and management of the performance of business activities with respect to the risk or the capital requirements; and
- Strategic planning with respect to the risk, allocated capital resources and capital efficiency of individual business activities of the Bank.

The Bank has established an internal limit for capital ratio at 12%. The Bank has implemented the standard approach for capital management which is in compliance with Basel II requirements.

CZKm	31 December 2016	31 December 2015
Tier 1 capital		
Share capital	2,632	2,132
Less: Own treasury shares	-	-
Other reserves	1,150	1,150
Retained earnings (without profit for the current year, statutory non-consolidated)	756	756
Less: Values adjusting according to requirements for prudent valuation	(1)	(2)
Less: intangible assets	(21)	(23)
Total qualifying Tier 1 capital	**4,516**	**4,013**
Total regulatory capital	**4,516**	**4,013**
Total risk weighted exposure	**22,667**	**21,735**
Capital ratio	**19.93%**	**18.46%**

5/ Fair values of assets and liabilities and fair value hierarchy

The fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. When available, fair value estimates are made based on quoted market prices. However, no readily available market prices exist for a significant portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other generally acceptable pricing models as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates might not be realized in a current sale of the financial instrument. In estimating the fair value of the Bank's financial instruments, the following methods and assumptions were used.

(a) Cash and balances with central banks

The carrying values of cash and balances within central banks are generally deemed to approximate their fair value.

(b) Securities held to maturity

Fair values of securities in the 'Held-to-Maturity' portfolio are taken from the active market, where these instruments are quoted.

(c) Due from banks

The fair value of amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk).

(d) Loans to customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

(e) Loans and advances to banks

The fair value of term deposits repayable on demand approximates the carrying value of amounts repayable on demand as of the period-end date. The fair value of term deposits at variable interest rates approximates their carrying values as of the period-end date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using market interest rates.

The following table summarizes the carrying values and fair values of those financial assets and liabilities not presented on the statement of financial position at their fair value:

CZKm	31 December 2016 Carrying value	31 December 2016 Fair value	31 December 2015 Carrying value	31 December 2015 Fair value
Financial assets				
Cash and balances with central banks	8	8	120	120
Loan and advances to banks	86	86	261	261
Loans to customers	6,691	6,538	9,057	8,859
- *Loans to private legal entities and individuals*	1,981	1,977	2,559	2,517
- *Loans to the Czech government entities*	4,279	4,180	5,931	5,777
- *Loans to municipalities*	431	381	567	565
Securities held to maturity	5,145	5,594	5,188	5,688
Other financial assets	37	37	41	41
Financial liabilities				
Amounts due to banks	6,849	6,798	9,742	9,619
Amounts due to customers	11,263	11,190	11,706	11,604
Other financial liabilities	218	218	230	230

Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed debt instruments on exchanges (for example Prague Stock Exchange and other recognized stock exchanges);
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes over-the-counter derivative contracts. The sources of input parameters like PRIBOR or other yield curves are Bloomberg and Reuters;
- Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes financial instruments with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Bank considers only relevant and observable market prices in its valuations and does not have any financial assets or liabilities at fair value to be categorized in Level 3. There have not been any reclassifications between the Levels 1 and 2 during the presented periods.

31 December 2016	**Level 1**	**Level 2**
Financial assets at fair value through profit and loss		
Financial assets held for trading		
- Debt securities	-	-
- Derivatives	-	80
Debt securities designated at fair value	529	-
Available-for-sale debt securities:	14,829	-
Total assets at fair value	**15,358**	**80**
Financial liabilities at fair value through profit and loss		
- Derivatives held for trading	-	93
Hedging derivatives	-	29
Total liabilities at fair value	**-**	**122**

31 December 2015	**Level 1**	**Level 2**
Financial assets at fair value through profit and loss		
Financial assets held for trading		
- Debt securities	113	-
- Derivatives	-	103
Debt securities designated at fair value	965	-
Available-for-sale debt securities:	14,912	-
Total assets at fair value	**15,990**	**103**
Financial liabilities at fair value through profit and loss		
- Derivatives held for trading	-	208
Hedging derivatives	-	36
Total liabilities at fair value	**-**	**244**

6/ Subsequent events

No significant events having a material impact on the financial statements of the Bank for the year ended 31 December 2016 occurred subsequent to the period-end date.

The Board of Directors has authorized these financial statements for submission to the General Meeting of Shareholders. These financial statements have been signed, on the basis of authority delegated by the Board of Directors, by Jiří Jirásek, Chairman of the Board and Ivan Duda, Member of the Board.

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