ČESKOMORAVSKÁ ZÁRUČNÍ A ROZVOJOVÁ BANKA, a.s.

2017

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.

Contents

Presentation part

Financial part

Chairman's introduction

The past year 2017, in which the Czech government adopted a resolution on the national development bank, confirmed a new direction for Českomoravská záruční a rozvojová banka, a.s. (CMZRB). This is not just an important milestone in the company's history but also marks a significant shift within the Czech Republic's economic policy. The Bank will now be even more involved in the development of the Czech economy and will promote greater use of financial instruments. This will ensure long-term stable support for businesses and thereby greater stability in the Czech Republic's economic growth.

Freeing up of the exchange rate and the UK's approaching exit from the EU have in no way influenced the continuing growth of the Czech economy. Even though interest rates edged up from their extreme lows, they remained at low levels throughout 2017. This supported entrepreneurs' and enterprises' interest to invest into their own further development, and it also heightened their interest in banking instruments. The demand for CMZRB guarantees grew year on year. Contributing to this was the extension of the Guarantee 2015-2023 Programme in the last quarter of 2017, when the conditions for businesses based in Prague and outside of Prague were unified. The programme was also opened to medium-sized businesses. In 2018, the Bank will strive to further increase the capacity of this programme.

Last June, CMZRB, in co-operation with the Ministry of Industry and Trade, launched the first financial instrument in the Operational Programme Enterprise and Innovation for Competitiveness. Specifically, this was the EXPANZE programme, which provides small and medium-sized enterprises with preferential financing of their investment projects through interest-free loans. Through the end of 2023, CZK 8.8 billion has been allocated for this programme from EU Structural Funds.

In addition to the EXPANZE programme, the Bank has implemented two more loan programmes. Their goal is to contribute to reducing energy consumption and boosting the use of renewable energy sources in business activities. The ENERG pilot programme was launched in June and offers preferential funding for projects of small and medium-sized enterprises implemented in Prague. From national resources, CZK 130 million have been allocated to this programme. The Energy Savings Programme provides interest-free loans for projects implemented by enterprises of any size anywhere in the Czech Republic outside the capital. This programme was launched in September 2017 and CZK 1.9 billion has been allocated to it through the end of 2023 within the Operational Programme Enterprise and Innovation for Competitiveness.

In the past year, CMZRB deepened its co-operation also with other state administration agencies and thereby opened the way to creating additional programmes for small and medium-sized enterprises. For example, the Ministry of Agriculture is preparing together with the Bank a programme of interest-free loans to support non-agricultural entrepreneurs in small municipalities. In the second half of the year, the Ministry of Foreign Affairs decided to involve CMZRB in the European Fund for Sustainable Development (EFSD), known as the Juncker Plan for external investment. On the basis of this initiative, the Bank will support the involvement of Czech entities in foreign development activities in countries defined by the EFSD.

In 2017, CMZRB also established deeper co-operation with other state institutions directed to supporting small and medium-sized enterprises. These are Czech Export Bank, a.s., Export Guarantee and Insurance Company, a.s., CzechTrade, CzechInvest, Czech Development Agency, and Czech Technology Agency. The objective of combining these institutions' strengths is to take advantage of synergies and thereby contribute to increasing both the efficiency and volume of support provided to businesses in the Czech Republic.

In addition, the Bank continued to be actively engaged in the activities of European associations of development or guarantee institutions such as ELTI, AECM, and NEFI. This collaboration brings together the experience of providing support to entrepreneurs across individual countries and identifies challenges and opportunities in the use of EU financial instruments.

In February of last year, the Bank became a shareholder in the European Investment Fund (EIF). This has served to intensify co-operation with this key institution that creates and manages a number of EU support programmes having major impact on public and private sector funding. At the end of last year, the Bank also joined the Central European Fund of Funds (CEFoF), which is managed by the EIF and will focus on providing venture capital support to growing, innovative companies in Central European countries.

The Bank therefore faces a number of challenges and new opportunities that will determine its further development. How it meets those challenges and pursues its further aims in supporting business and non-business entities will determine in the course of co-operation with other partners beyond those ministries that exercise shareholder rights in the Bank. The main business objective in 2018 will relate to its involvement in administering financial instruments within support programmes across individual ministries and other state agencies, including the implementation of products related to the Bank's involvement in such other programmes as EFSD and CEFoF.

CMZRB celebrated its 25th anniversary in March 2017. Through those years, it provided support to 60,000 businesses, municipalities and other market players. It is no less important that the Bank has undergone a generational change in the past two years. I have had a number of opportunities to see how experienced bankers have shared, and are sharing, their experience with the emerging younger generation. I would therefore like to thank all former and current employees for their work and the energy they have always put into that work for CMZRB. Thanks to this, the Bank again achieved excellent results last year while contributing to the development and stability of the Czech economy and banking sector.

I very much appreciate the efforts of the shareholder's representatives, which enabled us over the past year to become a national development bank and to launch several new support programmes. I firmly believe that through our joined efforts during 2018 we will further expand our product range, especially for small and medium-sized enterprises. Specifically, these will include such products as will complement the commercial sector and contribute to eliminating market failures and potential economic fluctuations.

Jiří Jirásek
Chairman of the Board of Directors

Profile of CMZRB, communication, and its further development

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.

The Bank's initial scope of activity was directed solely to implementing government programmes for the support of small and medium-sized enterprises. In 1997, its activity was extended to providing support in the housing area and it began to contribute substantially to repairing flood damage in affected areas of the Czech Republic. In 2000, it initiated financing of development projects in the areas of transport and environmental infrastructure. With the Czech Republic's entry into the EU in 2004, the Bank initiated deeper co-operation with European institutions and joined in financing of projects under EU funds. Last year, the Bank became a minority shareholder in the European Investment Fund (EIF).

CMZRB is 100% owned by the Czech Republic. It has a full banking licence, a foreign exchange licence, as well as a securities broker's licence issued under the relevant laws.

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

Small and medium-sized enterprises constitute the most important client group. Other users of the Bank's services include municipalities, regions, apartment owners associations, ministries and state funds. The Bank offers to its clients a growing portfolio of products and related banking services. It specialises in providing support in the form of financial instruments, i.e. bank guarantees and preferential loans complemented by financial subsidies, and most recently also investments in the form of capital contributions to investment funds. 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

The main mission of CMZRB, which according to the government's resolution from August 2017 fulfils the role of a national development bank, is to assist through the provision of financial instruments in the development of the national economy and in achieving economic policy objectives of the Czech government, the regions, and the EU. Using public resources, the Bank's own funds, and other financial resources (from such financial institutions as the European Investment Bank), it provides – and will continue to provide – preferential financial products to support economic and social development of the Czech Republic, especially for the development of small and medium-sized businesses, energy savings, use of renewable resources, development of municipalities and infrastructure, and support of science, research, and innovations.

In 2017, CMZRB celebrated its 25th anniversary. Since its founding, it has supported almost 60,000 entities, primarily small and medium-sized enterprises. This contribution has been recorded in the book "25 Years of CMZRB in 25 Stories". Through CMZRB clients' stories, it illustrates in which situations and in what manner it becomes involved with projects, how it complements the commercial sector, and what role it plays on the markets. When relating their stories, the clients have frequently attested to the fact that products from CMZRB helped them withstand a difficult period or facilitated their further development. They also positively assessed its client-oriented approach.

The results of its activities for the past quarter century and the intentions for its further development were presented also at the expert conference "25 years of supporting business in the Czech Republic and its future", which the Bank decided to organise for the first time in its history. Ministers and representatives of the European Investment Bank, commercial banks, and business associations met there on a single stage. With its appealing speakers and interesting content, the conference attracted more than 200 guests from among businesspeople, financial sector representatives, the state administration, and journalists.

Strengthening PR activities and modern marketing communication tools connected to the Bank's presentation in the media, on social networks, at seminars, conferences, and trade shows has had a positive effect on building relationships with both current and potential clients as well as with representatives of the financial sector, business associations, and state authorities. Personal meetings with these entities are crucially important for the Bank's further development. Even though these are often demanding in terms of expertise and time, they help ensure long-term stable support for businesses and other target groups.

Late last year, the Bank and the Ministry of Industry and Trade agreed on extending the Guarantee 2015-2023 Programme. This unified the conditions for businesses in Prague and outside of Prague and also opened the programme to medium-sized enterprises. In view of the strong demand for this product, the Bank will initiate discussion during 2018 towards increasing the programme's capacity.

At the turn of 2017 and 2018, the Ministry of Industry and Trade, CMZRB, and EIF agreed on the Czech Republic's involvement in the Central European Fund of Funds (CEFoF). Its objective is to support growing, innovative firms in Central European countries using venture capital. The CEFoF was launched at the end of January 2018, and CMZRB is participating as an investor. Thereby, the Bank has expanded its portfolio of financial instruments to include equity investments.

Co-operation with other ministries and other state institutions will facilitate updating of the general regulation for structural funds. This will allow managing authorities to assign administration of financial instruments directly without a procurement procedure to financial institutions fulfilling the specified criteria (CMZRB). The Omnibus Regulation is expected to come into effect during the spring of 2018.

For example, CMZRB is already preparing, in co-operation with the Ministry of Agriculture, a programme of interest-free loans to support non-agricultural enterprises in small municipalities. This had been approved by the government at the end of August 2017. The Ministry of Labour and Social Affairs also is considering as part of its Employment Operational Programme a possibility of supporting social entrepreneurs using financial instruments, in particular preferential loans administered by CMZRB.

The Ministry of the Environment is considering a similar form of co-operation as part of the Operational Programme Environment. This would constitute implementation of guarantee programmes for waste management projects. Similar collaboration is also being outlined with the City of Prague. It plans to use CMZRB's credit instruments to support enterprises in Prague under the Operational Programme Prague - Growth Pole.

The Bank also will play an active role in providing financial instruments for co-operation in international development between the Czech Republic, EU, and international financial institutions. In this respect, the Ministry of Foreign Affairs together with the Ministry of Industry and Trade decided to involve the Bank in the European Fund for Sustainable Development (EFSD), known as the Juncker Plan for external investment. Based on this initiative, the Bank will support the involvement of Czech entities in foreign development activities in countries defined by the EFSD. Therefore, it has asked the European Commission for a so-called pillar assessment on the basis of which its activities will expand in this direction.

No less important for the Bank, therefore, will be its co-operation with key agencies of the European Union, including the European Investment Fund, of which the Bank has been a shareholder since last year, and its partnership in international associations like NEFI (Network of European Financial Institutions for Small and Medium Sized Enterprises), AECM (European Association of Guarantee Institutions), and ELTI (European Long-Term Investors Association). Its involvement in international activities can – and will – play an important part in the Bank's further development.

Selected economic indicators

	Unit	2013	2014	2015	2016	2017
Total assets	CZK mil.	98,042	127,337	30,999	27,612	23,436
Liabilities	CZK mil.	93,591	122,642	26,124	22,253	18,350
Shareholder's equity	CZK mil.	4,451	4,695	4,875	5,359	5,086
Share capital	CZK mil.	2,132	2,132	2,132	2,632	2,632
Profit after tax	CZK mil.	348	262	196	28	29
Guarantee portfolio	CZK mil.	18,129	17,900	19,926	18,922	18,622
Capital ratio	%	16.0	17.1	18.5	19.9	21.5
Average number of employees	-	216	211	209	209	214
Branches	-	5	5	5	5	5

The Bank's shareholder holding all voting rights is the Czech Republic. It is 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 remunerating employees, and operates a social programme.

CMZRB has no foreign branches or subsidiaries.

In 2017, CMZRB did not acquire any of its own shares or ownership interests.

Governing bodies

Board of Directors

Chairman	Jiří Jirásek
Members	Ivan Duda
	Ivo Škrabal

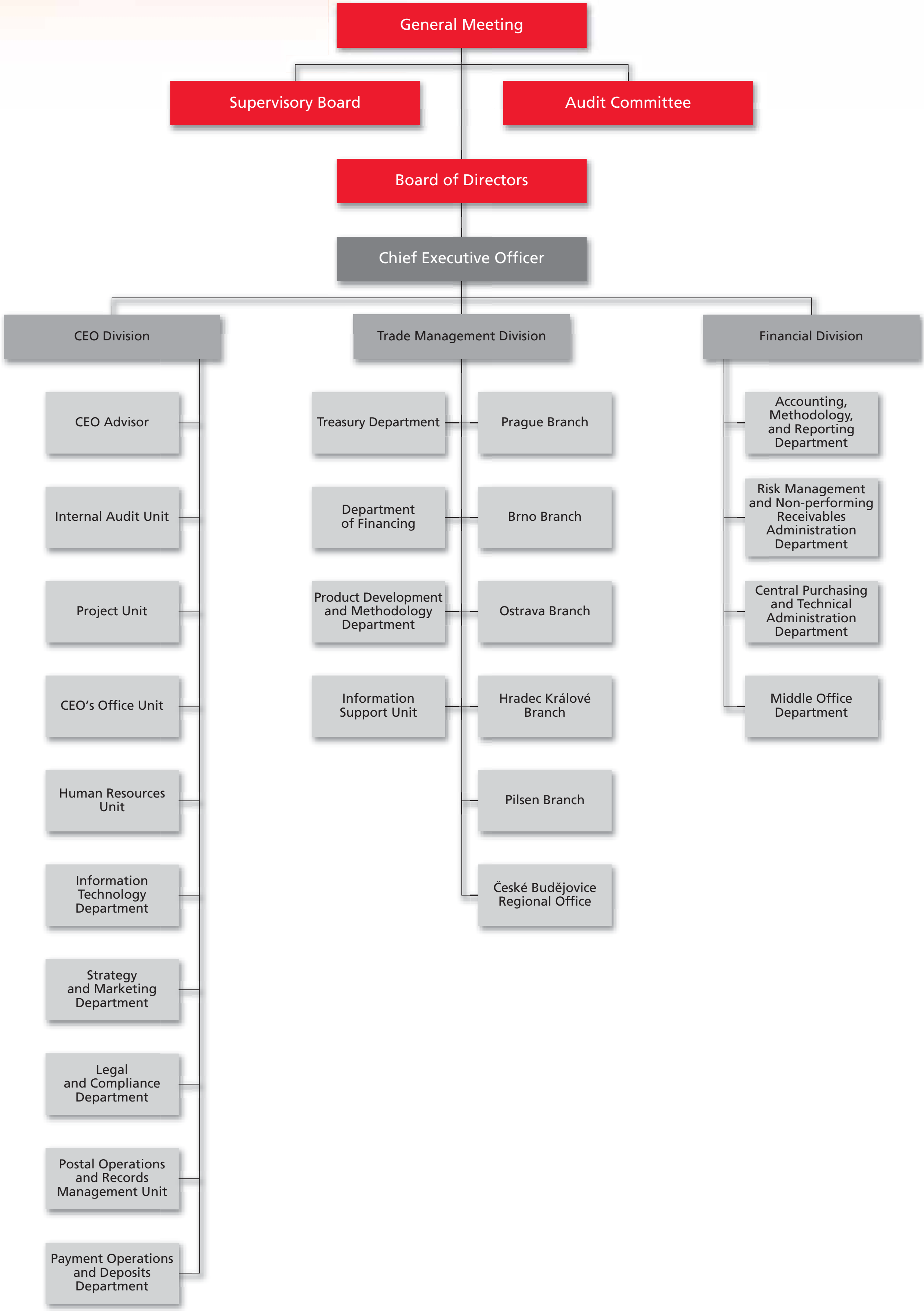
Supervisory Board

Chairman	Robert Szurman
Vice-Chairman	Pavel Závitkovský (member as from 25 April 2017, Vice-Chairman as from 13 June 2017)
Members	Lenka Dupáková
	Ladislav Koděra
	Marie Kotrlá (until 3 September 2017, member as from 23 January 2018)
	Olga Letáčková
	Zdeněk Mareš
	Tomáš Novotný
	Jana Šindelářová (until 5 June 2017)
	Luděk Šrein (as from 29 August 2017)

Audit Committee

Chairman	Milan Novák
Vice-Chairman	Josef Doruška (until 30 April 2017)
	Pavel Závitkovský (member as from 1 May 2017, Vice-Chairman as from 13 June 2017)
Members	Robert Szurman (until 30 April 2017)
	Tomáš Hlivka (as from 1 May 2017)

Organisation chart



Information for readers

The data disclosed up to page 31 of this Annual Review have been derived from the financial statements of Českomoravská záruční a rozvojová banka, a.s., as at 31 December 2017 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 2017 financial year

2017

annual review

Economic environment and its impact on the Bank's performance

The Czech Republic's economy recorded a 4.5% growth rate in the past year. Although growth slowed slightly in comparison with 2016 and 2015, the fact that it remained above the 2% level attained in 2014 showed the economy to be among the most strongly developing within the EU. As in previous years, most sectors of the national economy, and in particular manufacturing, contributed to the positive economic development. The Czech Republic also stands out within the EU for having the lowest unemployment rate, which reached as low as 3.8% during 2017.

In January 2018, Standard & Poor's in its latest evaluation confirmed the Czech Republic's rating with a stable outlook of AA– for long-term obligations in foreign currencies and AA for long-term obligations in the domestic currency. It therefore followed the other international rating agencies, which confirmed their ratings or improved their outlooks in the past year. The agency positively views especially the Czech Republic's low indebtedness, which is among the lowest in the EU, strong institutional structure and, last but not least, the Czech National Bank's great flexibility in conducting its monetary policy. It gives high marks for the strong economic growth of recent years and predicts that this will average 2.5% for the next four years.

The state budget spending during 2017 ended in a deficit of CZK 6.2 billion, which is CZK 53.8 billion less than had been approved. As compared to the result from 2016, for which a surplus of CZK 61.8 billion was reported, the fiscal outcome worsened by CZK 67.9 billion. That primarily was due to a CZK 81.9 billion decrease of funds received from the EU and financial mechanisms.

At the beginning of April last year, the CNB discontinued its exchange-rate intervention and the Czech crown began slowly to strengthen, reaching 25.54 CZK/EUR at the end of the year (the exchange rate at the end of the CNB's intervention had been 27.06 CZK/EUR). Despite this strengthening, the growth in exports in the second half of last year was at a faster rate than in the same period of the previous year. Large and medium-sized enterprises had the greatest share in the increased export activity.

Even though there occurred in 2017 a slight increase of the two-week repo rate from 0.05% in 2016 to 0.50%, interest rates nevertheless remained at a low level. In combination with persisting liquidity surplus, the low rates generated strong demand for credit instruments, including in the sector of small and medium-sized enterprises, thereby influencing the activity of banking institutions.

In this environment limiting the size of risk premiums, the low interest rates also put pressure on the amount and quality of security for business loans. Continued interest in CMZRB guarantees was a natural outcome of such circumstances. Due to the strong demand and modifications of conditions under the national Guarantee 2015-2023 Programme in the last quarter of 2017, the Bank surpassed the targets of its business plan.

In accordance with the requirements of Decree No. 501/2002 Coll., the Bank last year implemented IFRS 9 from International Financial Reporting Standards into its banking processes. The standard defines new requirements for reporting when initially classifying financial instruments at the time of concluding a business transaction, as well as for their valuation, accounting, and reporting. The introduction of this reporting standard brings crucial changes impacting on all aspects of business transactions, ranging from the relationship between the Bank and its clients and counterparties, to the processes of business units, transferring and evaluating data and information on each business transaction, to risk management and accounting for and reporting business transactions, and to measuring indicators of products' profitability and the Bank's overall performance. In view of the Bank's previous conservative approach to provisioning for risks, the implementation of IFRS 9 did not have a material impact in terms of additional impairment allowances and provisions. Thus, the impact on the Bank's shareholder's equity due to this change, as from 1 January 2018, would amount to an increase of less than 0.5%.

In the first half of 2017, negotiations were completed with the Ministry of Industry and Trade regarding financial instruments. CMZRB became the administrator for financial instruments in the Operational Programme Enterprise and Innovation for Competitiveness. In June, the EXPANZE Programme was launched, followed by the Energy Savings Programme in September. As an addition for projects implemented within the territory of the City of Prague, the latter was complemented by launch of the ENERG Programme, which is financed from national resources. The preferential loans provided under these three programmes enable a considerable part of small and medium-sized enterprises (as well as large enterprises in Energy Savings) to obtain bank loans more easily and under more advantageous conditions for initiating or developing their businesses. In addition to these loans, they may also receive financial subsidies to pay the interest on a commercial loan or a subsidy towards preparing energy audits.

Changes and promptings from the external environment have made conditions under which the Bank will operate more demanding. In coming years, CMZRB, along with the entire banking sector, will need to deal with the increased cost burdens of measures relating to personal data protection, increasing transparency of the provided support, and reducing tax evasion at the pan-European level.

Economic results

Basic economic characteristics of the Bank for 2013–2017

	Unit	2013	2014	2015	2016	2017
Total balance sheet	CZK mil.	98,042	127,337	30,999	27,612	23,436
Assets:						
Deposits and loans at banks	CZK mil.	63,884	91,060	261	86	262
Securities accepted by the Czech National Bank for refinancing	CZK mil.	7,783	9,946	10,474	16,195	15 430
Debt securities	CZK mil.	11,272	13,929	10,703	4,308	3 047
Payments from guarantees and other classified receivables	CZK mil.	3,556	3,082	2,477	1,942	1 452
Liabilities and equity:						
Shareholder's equity	CZK mil.	4,451	4,695	4,875	5,359	5 086
Liabilities	CZK mil.	93,591	122,642	26,124	22,253	18 350
of which: reserves	CZK mil.	2,495	2,909	3,124	3,165	3 214
funds to cover credit risks	CZK mil.	2,557	2,341	2,659	2,011	1 990
Off-balance sheet:						
Guarantees granted	CZK mil.	18,129	17,900	19,926	18,922	18 622
Total revenues	CZK mil.	3,505	2,969	2,785	2,453	2,023
of which: from securities and interbank operations	CZK mil.	516	426	376	319	269
from operations with clients	CZK mil.	686	568	454	329	226
Total expenses	CZK mil.	3,157	2,707	2,589	2,425	1,994
of which: net impairment allowances and provisions	CZK mil.	442	382	331	102	319
Profit after tax	CZK mil.	348	262	196	28	29
Capital ratio	%	16.0	17.1	18.5	19.9	21.5

The volume of newly concluded transactions in 2017 was CZK 9.4 billion (in 2016: CZK 9 billion), of which CZK 0.4 billion were credit transactions and CZK 9 billion guarantee transactions. The transactions were financed from the Bank's own resources, those of the programme's contracting authority (Ministry of Industry and Trade) for financing the costs of preferential guarantees in a programme supporting small and medium-sized enterprises, and those of the European Structural and Investment Funds within the EXPANZE programme. The total value of the guarantee and loan transaction portfolios decreased by 4.1% to CZK 20.5 billion, with the guarantee transaction portfolio declining by 1.6% to CZK 18.6 billion.

The decline in revenues from business activities continued in 2017, 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), decreasing share of assets with higher rates of return due to their gradual repayment, and the stagnating low returns from the bond market. Final net profit after tax of CZK 29 million is CZK 1 million higher than in 2016 and is in accordance with the Bank's policy of creating net profit. Shareholder's equity decreased from CZK 5.4 billion to CZK 5.1 billion year on year due to a decrease of valuation differences from available-for-sale financial assets by CZK 294 mil. The capital ratio as of 31 December 2017 stood at 21.5%, which is 1.6 percentage points greater than at the close of the previous year.

Credit risk continued to constitute the most significant type of risk impacting the Bank, and 92.2% of capital dedicated to risk coverage related to this type of risk. As of the end of 2017, 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 5.2 billion (i.e. 25.2% 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 programme originators in a total value of CZK 1.99 billion. As of the end of the year, moreover, the Bank had at its disposal reserve funds in shareholder's equity of CZK 1.35 billion.

The overall balance sheet at the end of 2017 was smaller by 15.1%, at CZK 23.4 billion. In particular, liabilities due to financial institutions had diminished by CZK 3.2 billion, amounts due to clients by CZK 0.5 billion, other liabilities and deferred income by CZK 0.2 billion, and valuation differences by CZK 0.3 billion. On the assets side, amounts due from clients, in particular, were lower by CZK 2.3 billion, values of bonds were down by CZK 2.0 billion, and other assets by CZK 0.1 billion. Amounts due from banks were higher by CZK 0.2 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 18.6 billion as of the end of 2017.

On the assets side, the Bank had at its disposal a portfolio of financial investments amounting to CZK 18.8 billion (80.1% of net assets) and placed predominantly into state bonds and bonds of selected banks and companies (78.8% of net assets). Important net asset items reported in loans and advances to customers were loans provided to state institutions (10.8% of net assets) and loans to other clients (7.8% of net assets). Non-earning assets comprised 0.9% of the total balance sheet.

The funding sources on the liabilities and equity side were provided primarily by amounts due to customers – programme originators (45.9% of liabilities and equity) and banks (15.8% of liabilities and equity), shareholder's equity (21.7% of liabilities and equity), provisions (13.7% of liabilities and equity), as well as temporary and other liabilities.

Determination of capital ratio and other additional indicators

Indikator	Unit	2013	2014	2015	2016	2017
Tier 1 (T1) capital	CZK '000	**3,876,104**	**3,867,425**	**4,012,794**	**4,516,436**	**4,532,379**
Common equity tier 1 (CET1) capital	CZK '000	**3,876,104**	**3,867,425**	**4,012,794**	**4,516,436**	**4,532,379**
Instruments eligible for CET1 capital	CZK '000	**237,810**	**1,355,628**	**2,131,550**	**2,631,626**	**2,631,626**
Paid-in CET1 instruments	CZK '000	2,131,550	2,131,550	2,131,550	2,631,626	2,631,626
Acquired own CET1 instruments	CZK '000	**-1,893,740**	**-775,922**	**0**	**0**	**0**
Own CET1 instruments acquired directly	CZK '000	-1,893,740	-775,922	0	0	0
Retained earnings/accumulated losses	**CZK '000**	**2,519,209**	**1,413,018**	**756,011**	**756,011**	**765,925**
Retained earnings/accumulated losses from previous years	CZK '000	2,519,209	1,413,018	756,011	756,011	765,925
Accumulated other comprehensive income	CZK '000	0	514,099	640,738	0	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	-18,546	-1,425	-732	-271
Value adjustments pursuant to prudential revaluation requirements	CZK '000	0	-18,546	-1,425	-732	-271
Other intangible assets	CZK '000	**-30,915**	**-32,675**	**-23,342**	**-20,469**	**-14,901**
Other intangible assets – gross value	CZK '000	-30,915	-32,675	-23,342	-20,469	-14,901
Other transitional adjustments to CET1 capital	CZK '000	0	-514,099	-640,738	0	0
Tier 2 (T2) capital	CZK '000	**0**	**0**	**0**	**0**	**0**
Capital	CZK '000	**3,876,104**	**3,867,425**	**4,012,794**	**4,516,436**	**4,532,379**
Total risk exposure	CZK '000	24,183,705	22,563,626	21,734,647	22,666,565	21,070,912
Total risk-weighted exposure relating to credit risk pursuant to the Standardised Approach	CZK '000	**20,526,097**	**18,765,897**	**18,830,208**	**20,583,545**	**19,377,445**
Exposures to central governments and banks	CZK '000	89,147	31,084	0	0	0
Exposures to regional governments and local bodies	CZK '000	355,538	205,584	194,933	168,033	159,126
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	1,059,241	1,114,966	976,616	776,680	652,756

Indikator	Unit	2013	2014	2015	2016	2017
Exposures to enterprises	CZK '000	16,912,362	14,904,965	14,596,311	17,342,648	16,571,663
Exposures to retail	CZK '000	692,337	1,428,522	1,953,670	71,936	108,255
Exposures secured by property	CZK '000	89,595	156,394	130,822	90,453	60,051
Exposures in default	CZK '000	565,639	493,518	618,619	827,920	774,117
High-risk exposures	CZK '000	0	0	0	1,017,563	757,278
Exposures in covered bonds	CZK '000	671,612	144,034	62,779	61,462	40,124
Exposures to institutions and enterprises with short-term credit evaluation	CZK '000	26,379	77,467	98,978	39,436	39,640
Collective investment instruments	CZK '000	0	0	0	0	0
Equities	CZK '000	0	1,347	1,347	1,347	49,964
Other exposures	CZK '000	64,247	208,016	196,133	186,067	164,471
Risk exposure relating to position, foreign exchange and commodity risks pursuant to the Standardised Approach	CZK '000	**622,385**	**592,813**	**102,907**	**0**	**0**
Tradable debt instruments	CZK '000	622,385	592,813	102,907	0	0
Currency transactions	CZK '000	0	0	0	0	0
Total risk exposure relating to operational risk	CZK '000	**3,035,223**	**2,909,928**	**2,678,764**	**1,945,764**	**1,636,305**
Operational risk – basic indicator approach	CZK '000	3,035,223	2,909,928	2,678,764	1,945,764	1,636,305
Total risk exposure relating to revaluation adjustments to credit risk	CZK '000	**0**	**294,988**	**122,768**	**137,256**	**57,162**
Standardised Approach	CZK '000	0	294,988	122,768	137,256	57,162
Capital ratio for Tier 1 equity capital	%	16.03	17.14	18.46	19.93	21.51
Capital ratio for Tier 1 capital	%	16.03	17.14	18.46	19.93	21.51
Capital ratio for total capital	%	16.03	17.14	18.46	19.93	21.51
Return on average assets (ROAA)[1]	%	0.41	0.35	0.24	0.04	0.10
Return on average equity (ROAE)[1]	%	9.02	6.81	5.01	0.68	0.63
Assets per employee[1]	CZK '000	445,646	595,033	148,322	130,246	110,027
Administrative costs per employee[1]	CZK '000	1,356	1,455	1,438	1,474	1,471
Net profit per employee[1]	CZK '000	1,583	1,226	939	130	134

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 2017 and 31 December 2016, thus providing complete reconciliation of individual regulatory capital lines with the institution's capital and the balance sheet.

[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 2017	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	-	-
Retained earnings from previous periods	766	766
Profit for the period	-	29
Accumulated other comprehensive income	-	309
Other reserve funds	1,150	1,350
(–) Value adjustments pursuant to prudential revaluation requirements (additional value adjustments)	-1	-
(–) Intangible assets other than goodwill	-15	-
(–) Adjustments relating to unrealised gains and losses	-	-
Total capital eligible for inclusion into Tier 1	**4,532**	
Total shareholder's equity		**5,086**
Total Tier 2 capital	0	
Capital relevant for calculating large exposure limits, qualified participation limits and capital ratio	**4,532**	

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**	

Business activities

1/ Product overview

During 2017, the Bank provided the following products:

a) Guarantees

- GUARANTEE 2015-2023 Programme:
  - A portfolio guarantee for bank loans provided by a simplified procedure up to CZK 4 million and to as much as 70% of the loan principal for small and medium-sized enterprises; and
  - An individual guarantee for bank loans to as much as 80% of the loan principal for social enterprises (small and medium-sized), with maximum guarantee amount of CZK 20 million, including a financial contribution of 10% of the guaranteed loan amount drawn for eligible costs up to a maximum of CZK 500,000.
- INOSTART Programme – a guarantee for bank loans 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.
- Guarantees for tender bids for small and medium-sized enterprises in amounts of CZK 50,000 to CZK 5 million.

b) Loans

- EXPANZE Programme – preferential interest-free investment loans for small and medium-sized enterprises anywhere in the Czech Republic (with the exception of the Capital City of Prague) in amounts up to CZK 45 million, with maturity up to 7 years, and an interest rate subsidy in amounts up to CZK 1 million in case the project is implemented in one of the preferential regions.
- Energy Savings Programme – preferential interest-free loans for enterprises of any size anywhere in the Czech Republic (with the exception of the Capital City of Prague) with the objective of creating energy savings in amounts up to CZK 75 million, with maturity up to 10 years, and a financial contribution for acquiring an energy audit in amounts up to CZK 250,000 and, if savings are achieved, also an interest rate subsidy for a commercial loan in amounts up to CZK 1.5 million.
- ENERG Programme – preferential interest-free loans for small and medium-sized enterprises and their projects in the Capital City of Prague, aimed at energy savings in their business activities in amounts up to CZK 20 million and maturity up to 10 let, and a financial contribution for acquiring an energy audit in amounts up to CZK 100,000 and, if energy savings are achieved, a financial contribution equal to 7% of the amount of the preferential loan drawn.
- Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemia Region – loans for small enterprises in amounts up to CZK 1 million with a fixed interest rate of 4% p.a. and maturity up to 6 years, as well as loans for municipalities in the South Bohemia Region of up to CZK 2 million and maturity up to 10 years.
- Regional development fund – long-term loans 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.
- OBEC 2 Programme – long-term loans for cities, municipalities, and associations of municipalities in the Czech Republic for financing investments to improve living conditions or environmental protection up to CZK 130 million with fixed or variable interest rate determined individually based on current market conditions, maturity of up to 15 years, and with 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.

The Bank's programme in 2017 was again the Guarantee 2015-2023 Programme, which supports small and medium enterprises through guarantees. The conditions for providing guarantees were modified in November 2017, thereby improving this programme's accessibility also to enterprises based outside of Prague. In addition to small businesses, guarantees for investment loans could now be acquired by medium-sized entrepreneurs (with up to 249 employees). The scope of business activities supported was also expanded.

The results of implementing this programme (especially after the expansion from 1 November 2017) confirmed a growing interest in the use of guarantees. In addition to using national resources, the Guarantee 2015–2023 Programme is co-financed also using funds from the European Investment Fund under the COSME programme.

Provision of guarantees for loans to start-up enterprises for innovative projects within the INOSTART programme continued in 2017.

Based on the Bank's agreement with the South Bohemia Region, preferential loans were provided to small enterprises also in 2017 within the "Jihočech" programme.

Starting from 1 June 2017, the Bank began providing preferential loans within the EXPANZE Programme. The programme offers interest-free loans and interest rate subsidies for small and medium-sized enterprises aimed at financing investment projects anywhere in the Czech Republic with the exception of the Capital City of Prague. The EXPANZE Programme was prepared by the Ministry of Industry and Trade in co-operation with CMZRB. A total of CZK 8.8 billion will be allocated to this programme within the Operational Programme Enterprise and Innovations for Competitiveness (OP PIK).

The programmes ENERG (financed from national resources) and Energy Savings (financed from OP PIK) were started in mid-2017 and in mid-September 2017, respectively. Their objective is to contribute to reducing energy consupmtion and increasing the utilisation of renewable energy sources in business. In both cases, they are credit instruments of support complemented with interest rate subsidies for commercial loans or for acquiring of an energy audit.

During 2017, SMEs submitted a total of 2,481 applications for support in the forms of loan guarantees or loans (see Table 1). Of this number, 2,163 applications were approved and 22 applications were rejected. Another 145 applications were withdrawn by the applicants during processing. The remaining 151 applications were not resolved in 2017 and will carry over into 2018.

Applications for support received in 2017 and their settlement as at 31 December 2017 Table 1

Indicator		**2013**	**2014**	**2015**	**2016**	**2017**
Total applications submitted	Number	1,903	2,423	3,275	2,078	2,481
Approved	Number	1,563	1,988	2,688	1,848	2,163
Rejected or withdrawn	Number	229	210	581	124	167
Carried into following year	Number	111	225	6	106	151

The guarantees provided were directed to small enterprises with up to 49 employees, whereas loans were used the most by medium-sized enterprises with 50 to 249 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	1,385	64.5	2,339.0	58.3	22	42.3	45.7	15.7
10 to 49	748	34.8	1,618.6	40.3	14	26.9	74.1	25.4
50 to 249	16	0.7	56.2	1.4	16	30.8	171.6	58.9
Total	**2,149**	**100.0**	**4,013.8**	**100.0**	**52**	**100.0**	**291.4**	**100.0**

b) Guarantees

The Bank concluded in 2017 a total of 4,368 guarantee contracts totalling CZK 8,950 million (including amendments to contracts and extensions of guarantee maturity). The guarantees supported loans of CZK 12,791 million (see Table 3).

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

Indicator		2013	2014	2015	2016	2017
Guarantees issued	Number	2,347	3,273	4,307	3,972	4,368
Amount of guarantees issued	CZK mil.	6,106	7,627	10,894	8,819	8,950
Amount of loans guaranteed	CZK mil.	8,724	10,895	15,564	12,598	12,791
Average guarantee coverage	%	70	70	70	70	70

In the national GUARANTEE 2015-2023 Programme, SMEs obtained guarantees in the amount of CZK 3,979 million. These guarantees were used as security for 2,142 loans in amounts totalling CZK 5,718 million.

Based on a commitment to extend the guarantee period, the Bank prolonged this period through amendments to guarantee contracts for 2,219 guarantees summing to CZK 4,936 million. This enabled entrepreneurs to draw additional credit to finance capital needs.

Start-up enterprises were provided with 7 guarantees in total volume of CZK 35 million within the INOSTART programme.

The largest proportions of guarantees within the national GUARANTEE 2015-2023 Programme 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 within the Guarantee 2015–2023 Programme
(in % of contracted value of guarantees issued) — Table 4

Region		2013	2014	2015	2016	2017
Praha (Capital City of Prague)	%	11.2	14.2	14.7	30.9	26.1
Středočeský (Central Bohemia)	%	8.2	10.6	10.2	8.0	6.8
Jihočeský (South Bohemia)	%	5.5	5.9	7.5	4.4	5.1
Plzeňský (Pilsen)	%	4.6	4.7	5.6	4.6	4.3
Karlovarský (Karlovy Vary)	%	1.5	1.1	1.4	0.9	1.6
Ústecký (Ústí nad Labem)	%	3.7	2.8	3.3	2.5	3.3
Liberecký (Liberec)	%	3.9	3.3	3.1	2.0	3.7
Královéhradecký (Hradec Králové)	%	4.6	4.6	6.2	3.8	4.7
Pardubický (Pardubice)	%	4.7	4.1	4.1	3.8	4.6
Vysočina (Bohemian–Moravian Highlands)	%	3.1	3.1	3.2	3.3	3.5
Jihomoravský (the South Moravian Region)	%	14.0	13.1	12.8	13.0	11.0
Olomoucký (Olomouc)	%	6.8	8.0	7.3	5.0	6.4
Zlínský (Zlín)	%	6.0	4.7	5.2	5.4	4.9
Moravskoslezský (the Moravian–Silesian Region)	%	22.2	19.8	15.4	12.4	14.0
Total	**%**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

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

Sector structure of guarantees provided in 2017
(in % of contracted value of newly issued guarantees) Table 5

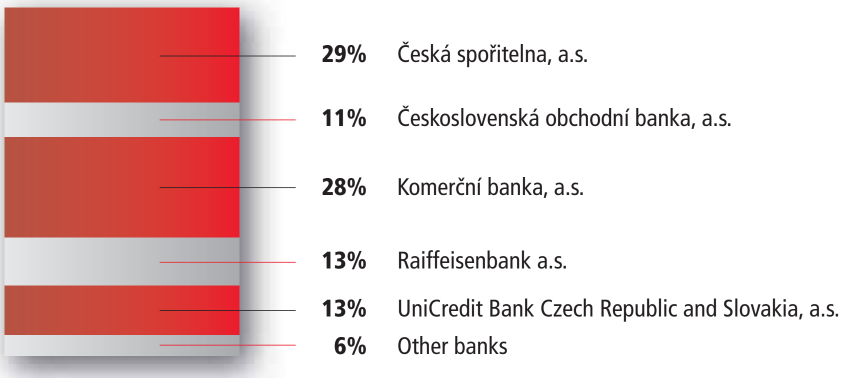
Sector		
Manufacturing (CZ NACE 10-33)	%	18.4
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	0.0
Construction (CZ NACE 41-43)	%	9.7
Wholesale and retail trade; repair and maintenance of motor vehicles (CZ NACE 45-47)	%	52.6
Accommodation and food service activities (CZ NACE 55-56)	%	4.9
Other service activities (CZ NACE 05-09, 36-39, 49-53, 58-75, 77-82, 84-88, 90-99)	%	14.4
Total	%	**100.0**

A breakdown of the most important co-operating banks is presented in Graph 1. During 2017, the majority of guaranteed transactions were concluded with Česká spořitelna, a.s., and Komerční banka, a.s.

Shares of banks co-operating within the GUARANTEE 2015–2023 Programme Graph 1.

Graph 1

Percentage breakdown of guarantee transactions by lending banks (2017)



In addition to guarantees for bank loans, 169 guarantees were provided for bids to public tenders in the amount of CZK 84 million.

c) Loans

During 2017, the Bank provided 56 loans overall in total volume of CZK 357 million.

In the EXPANZE Programme launched on 1 June 2017, 38 loan contracts were concluded totalling CZK 281 million. Total expected costs of the supported projects were CZK 630 million.

Within the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemia Region, 14 loans for small businesses and municipalities were provided in a total volume of CZK 10.9 million.

In 2017, the Bank provided 4 loans from the Regional Development Fund in a total amount of CZK 65.5 million.

Preferential loans provided Table 6

Indicator		2013	2014	2015	2016	2017
Loans provided	Number	17	36	27	9	56
Amount of loans provided	CZK million	101	86	65	7	357
Average loan amount	CZK million	6.0	2.3	2.4	0.8	6.4

Loans were supported most in the manufacturing sector (see Table 7).

Sector structure of loans provided in 2017
(in % of contracted value of newly issued loans) Table 7

Sector		
Manufacturing (CZ NACE 10-33)	%	74.7
Construction (CZ NACE 41-43)	%	1.5
Wholesale and retail trade; repair and maintenance of motor vehicles (CZ NACE 45-47)	%	3.9
Other service activities (CZ NACE 05-09, 36-39, 49-53, 58-75, 77-82, 84-88, 90-99)	%	19.9
Total	%	**100.0**

3/ Support for reconstructing apartment houses

In 2017, the Bank administered a total of 8,881 Contracts on Providing Grants to Cover Loan Interest. On the basis of these, it paid out CZK 782 million during 2017. From the start of the programme in support of apartment house reconstruction through the end of 2017, grant recipients were collectively paid a total of CZK 9,482 million, which comprises 69.4% of the total volume of concluded Contracts on Providing Grants to Cover Loan Interest (CZK 13,664 million).

The Bank also administered during 2017 a portfolio of bank loan guarantees enabling owners or co-owners of apartment houses to obtain loans for their repair. As of the end of 2017, this portfolio consisted of 1,284 bank loan guarantees (of which 106 were portfolio guarantees), and the outstanding balance in PANEL guarantees amounted to CZK 3,003 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 real estate for business activities, as well as sport, cultural and educational facilities. Issuance of these loans depends upon the generation of sufficient funds from repayment of loans from previous years.

In 2017, the Bank provided 4 loans totalling CZK 65.5 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 technical infrastructure owned by municipalities within the South Bohemian Region.

In 2017, the Bank provided 2 loans totalling CZK 2.8 million.

The total volumes of loans provided are stated in Table 6.

5/ Trading on financial markets

In 2017, the Bank was active 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 1,429 million during 2017. 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 2017, the Bank continued administering interest payments from commercial loans for participants in the Project for Construction and Renovation of Water Supply and Sewerage Infrastructure, paying out more than CZK 14 million to 90 recipients. Since the start of the interest rate subsidies administration programme in 2009, the total volume of disbursed interest rate subsidies had reached CZK 210 million as of 31 December 2017.

Report of the Supervisory Board
of Českomoravská záruční a rozvojová banka, a.s. for 2017

The Supervisory Board regularly carried out its duties during 2017 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 its strategy. 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 2017, and based upon 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, and the financial statements prepared on the basis of such accounting records present a true and fair view of the Bank's accounting and financial position.

KPMG Česká republika Audit, s.r.o. conducted 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 2017 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 the financial statements and proposed distribution of profits for the 2017 accounting period. Based upon the facts stated above and pursuant to the valid Articles of Association of Českomoravská záruční a rozvojová banka, a.s., the Supervisory Board recommends that the sole shareholder in exercising the powers of the General Meeting of Českomoravská záruční a rozvojová banka, a.s. approves the regular financial statements and the proposed distribution of profits for 2017 as presented by the Bank's Board of Directors.

The Supervisory Board also reviewed the Report on Relations between Related Entities for 2017 and reviewed the Bank's Annual Report for 2017. It recommends that the sole shareholder in exercising the powers of the General Meeting of the Bank approves these documents.

Prague, 24 April 2018

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 2017, 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 performing the activities 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 2017 the process of compiling the Bank’s financial statements for 2016 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 2016 MiFID report. Last year’s co-operation with the external auditor proceeded without issue.

In accordance with the Act on Auditors, the Audit Committee discussed and approved the provision of non-audit services to the Bank by KPMG Česká republika, specifically:

- providing training in bank regulations;
- advisory within the project for implementation of IFRS 9;
- preparing a differential analysis concerning the impacts of the MiFID II, CSMAD, and MAR regulatory measures on internal processes and the Bank’s regulations;
- providing a “Confirmation on accounting for a receivable” for the purposes of insolvency proceedings;
- processing and submitting a corporate income tax return for 2017, providing tax advisory for current tax issues;
- verifying by the auditor regarding the data on obligations for the purpose of calculating the contribution to the Crisis Resolution Fund.

The Audit Committee prepared the Report on the Activity of the Audit Committee for 2016 and submitted it to the Public Audit Oversight Board.

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 2017, the Audit Committee also reviewed the Report on the Information Systems Audit, which was conducted by the audit firm EY Česká republika, as well as information on implementation of MS Office 2016 within the Bank and information on the security of communication networks, especially from the perspective of possible breaches in the Bank’s information systems.

The Audit Committee in 2017 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 Risk Committee, the Audit Committee evaluated the Bank’s system of financial risk management; the plan for remedial procedures and crisis resolution for the Bank; the report on valuing assets, liabilities and off-balance sheet items and their reflection in the offer to clients while taking into account the business model and strategies for risk; as well as 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, 20 March 2018

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.

2017

annual review

KPMG

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

Report on the Audit of the Financial Statements

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 2017, 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 2017, 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, Regulation (EU) No. 537/2014 of the European Parliament and of the Council 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.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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 2017, based on which this independent auditor's report has been prepared.

Prague
27 March 2018

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

Veronika Strolená
Partner
Registration number 2195

Financial statements for the year ended 31 December 2017 prepared in accordance with IFRS as adopted by the EU

2017

annual review

Income statement

	Note	Year ended 31 December 2017 CZKm	Year ended 31 December 2016 CZKm
Interest and similar income		507	648
Interest and similar expenses		(195)	(277)
Net interest income	**3.1**	**312**	**371**
Fee and commission income		293	323
Fee and commission expenses		(2)	(2)
Net fee and commission income	**3.2**	**291**	**321**
Gains from financial operations	3.3	87	41
Losses on financial operations	3.3	(82)	(34)
Administrative expenses	3.4	(345)	(351)
Increase in loan impairment and write-offs	3.5	(270)	(61)
(Increase)/decrease in provisions for guarantees and other provisions	3.6	(3)	8
Other operating income		(26)	(136)
Operating profit or loss		**(36)**	**159**
Share of earnings in associates accounted for using the equity method	3.15	2	-
Profit or loss before income tax		**(34)**	**159**
Income tax expense	3.7	(41)	(139)
Profit or loss for the year		**(75)**	**20**

Statement of comprehensive income

	Note	Year ended 31 December 2017 CZKm	Year ended 31 December 2016 CZKm
Profit or loss for the year		**(75)**	**20**
Other comprehensive income			
Valuation gains/(losses) on available-for-sale financial assets		(341)	(11)
Net gains/(losses) on available-for-sale financial assets transferred to income statement on disposal	3.3	(22)	(34)
Deferred income tax relating to components of the comprehensive income	3.7	69	8
Other comprehensive income for the year, net of tax		(294)	(37)
Total comprehensive income		**(369)**	**(17)**

Statement of financial position

	Note	31 December 2017 CZKm	31 December 2016 CZKm
Assets			
Cash and balances with central banks	3.8	264	8
Loans and advances to banks	3.9	82	86
Financial assets held for trading			
- Debt securities	3.10	-	-
- Derivatives	4.2.2	15	80
Debt securities designated at fair value	3.10	173	529
Loans and advances to customers	3.11	4,378	6,691
Financial assets available for sale			
- Equity instruments	3.12	32	-
- Debt securities	3.12	13,696	14,829
of which: assets pledged as collateral		-	862
Financial assets held to maturity	3.13	4,608	5,145
of which: assets pledged as collateral		-	-
Current income tax assets	3.7	7	36
Investment in associate	3.15	12	108
Intangible assets		15	21
Property, plant and equipment	3.16	118	124
Other assets	3.14	47	62
Total assets		**23,447**	**27,719**
Liabilities			
Deposits from banks	3.17	3,698	6,849
Deposits from customers	3.18	10,748	11,263
Financial liabilities held for trading - derivatives	4.2	58	93
Hedging derivatives	4.2.2	25	29
Current income tax liabilities	3.7	-	-
Deferred tax liabilities	3.7	60	129
Provisions	3.6	3,214	3,165
Other liabilities	3.19	555	733
Total liabilities		**18,358**	**22,261**
Shareholders' equity			
Share capital	3.20	2,632	2,632
Statutory and other reserves		1,350	1,339
Revaluation reserve for AFS securities		310	604
Retained earnings		797	883
Total shareholders' equity		**5,089**	**5,458**
Total liabilities and shareholders' equity		**23,447**	**27,719**

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 27 March 2018.

Jiří Jirásek
Chairman of the Board

Ivan Duda
Member of the Board

Statement of changes in equity

		Share capital	Statutory and other reserves	Revaluation reserve for AFS securities	Retained earnings	Total
		CZKm	CZKm	CZKm	CZKm	CZKm
Balance at 1 January 2016		**2,132**	**1,150**	**641**	**1,052**	**4,975**
Profit or loss 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**
Profit or loss for the period		-	-	-	(75)	(75)
Net fair value gains on AFS securities		-	-	(341)	-	(341)
Net gains on AFS securities transferred to income statement	-	-	(22)	-	(22)	
Deferred income tax relating to components of other comprehensive income		-	-	69	-	69
Total comprehensive income		-	-	(294)	(75)	(369)
Allocation of profit to other funds		-	11	-	(11)	-
Balance at 31 December 2017		**2,632**	**1,350**	**310**	**797**	**5,089**

Statement of cash flows

	Note	2017 CZKm	2016 CZKm
Profit or loss before income tax		(34)	159
Adjustments for non-cash transactions			
Loans impairment and write-offs and provisions for guarantees		273	53
Depreciation and amortization		25	31
Share of profit of associates		(2)	-
Change in fair values and foreign exchange differences		(32)	(124)
Other non-cash items		12	14
Net interest income		(312)	(371)
Fee and commission income		(293)	(323)
		(363)	(561)
(Increase)/decrease in operating assets			
Loans and advances to banks		-	115
Loans and advances to customers		2,481	2,657
Other assets		358	567
Increase/(decrease) in operating liabilities			
Deposits from banks		(3,137)	(2,879)
Deposits from customers		(516)	(442)
Other liabilities		(61)	(319)
Interest received		560	693
Interest paid		(162)	(241)
Dividends received		98	-
Fee and commission received		144	147
Net cash flow from operating activities before income tax and payments under guarantee calls		(598)	(263)
Payments made under guarantee calls		(386)	(373)
Income taxes paid		(48)	(73)
Net cash flow from operating activities		**(1,032)**	**(709)**
Cash flows from investing activities			
Purchases of securities		(781)	(1,602)
Sales of securities and proceeds from matured securities		2,091	1,675
Purchase of tangible and intangible assets		(26)	(35)
Net cash flow from investing activities		**(252)**	**(671)**
Cash flows from financing activities			
Capital increase		-	500
Dividends paid		-	-
Net cash flow from financing activities		**-**	**500**
Net increase/ (decrease) in cash and cash equivalents		**252**	**(171)**
Cash and cash equivalents at the beginning of the year	**3.21**	**16**	**187**
Cash and cash equivalents at the end of the year	**3.21**	**268**	**16**

Notes to the financial statements

2017

annual review

Notes to the financial statements

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 2017

The Bank used its own resources to co-finance guarantees for the SME sector under the national guarantee programme. This enabled maintaining continuity in support for SMEs in 2017.

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 2017

The following revised standards effective from 1 January 2017 are mandatory and relevant for the Bank and have been applied by the Bank since 1 January 2017.

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 have a significant impact on the financial statements of the Bank.

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 2017, 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 15 Revenue from Contracts with Customers (effective from 1 January 2018) implements the unified principle-based five-step model applicable to all customer agreements:

- Identifies contract (contracts) with customer;
- Identifies the performance obligation arising from the contract;
- Defines the transaction price;
- Allocates the transaction price to individual performance obligations;
- Requires income recognition when fulfilling the obligation arising from the contract.

IFRS 15 also establishes the principles that an entity shall apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. Based on assessment listed above the Bank does not expect that the new Standard, when initially applied, will have material impact on the Bank's financial statements. The timing and measurement of the Bank's relevant revenues are not expected to change significantly under IFRS 15 because of the nature of the Bank's operations and the types of revenues it earns.

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.

Classification and Measurement

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.

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. IFRS 9 includes three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). It eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

A financial asset is measured at amortized cost if the following two conditions are met and is not designated as at FVTPL:

- The asset 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.

A financial asset is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- It is held within the business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- Its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount 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. This election is made on an investment-by-investment basis.

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.

All financial assets not classified as measured at amortized cost or FVOCI as described above are measured at FVTPL.

IFRS 9 largely retains the existing requirements in IAS 39 for classification of financial liabilities.

Impairment

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.

The new impairment model applies to the following financial instruments that are not measured at FVTPL:

- Financial assets that are debt instruments;
- Lease receivables; and
- Loan commitments and financial guarantee contracts issued.

Under IFRS 9, no impairment loss is recognized on equity investments. However, under IAS 39 all fair value changes of financial liabilities designated as at FVTPL are recognized in profit or loss, whereas under IFRS 9 these fair value changes will generally be presented as follows:

- The amount in the change of fair value that is attributable to changes in the credit risk of the liability will be presented in OCI; and
- The remaining amount of the change in fair value will be presented in profit and loss.

In accordance with the IFRS 9 model, credit losses should be recognised using a loan loss allowance in an amount:

- Equal to 12-month expected credit losses (expected credit losses on financial instruments are the result of loss-making events that may occur within 12 months since the balance sheet date) or;
- Expected credit losses over the life of the financial instrument (expected credit losses that are the result of all possible events causing a loss over the life of the financial instrument).

Loan loss allowances for expected credit losses over the life of a financial instrument are obligatory if the credit risk for the instrument has increased significantly since initial recognition. Assessing whether there has been a significant increase in credit risk is based on a higher probability that a default will occur after the initial recognition or if the financial instrument's contractual terms are violated.

Impact

The Bank has made an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management.

Summary of financial instruments measurement under IAS 39 and IFRS 9

Assets as at 31. 12. 2017	Measurement under IAS 39	Measurement under IFRS 9
Cash and balances with central banks	Amortized cost	Amortized cost
Loans and advances to bank	Amortized cost	Amortized cost
Loans and advances to customers	Amortized cost	Amortized cost or FVTPL
Financial assets available for sale	AFS	FVTPL or FVOCI
Financial assets held to maturity	Amortized cost	Amortized cost
Financial assets designated at fair value	FVTPL	FVTPL
Financial assets held for trading	FVTPL	FVTPL
Financial liabilities designated at FVTPL	FVTPL	FVTPL
Financial liabilities	Amortized cost	Amortized cost

The Bank will apply IFRS 9 initially on 1 January 2018. The new standard will have an impact on Bank’s financial statements due change in measurement of financial assets and liabilities as mentioned above. The impact on Bank’s financial statements is immaterial.

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.

(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 2017 or 2016.

(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 2017 or 2016.

(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 of 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 38 million higher/lower.

(q) Participation of the Bank in the Central European Fund of Funds

Based on Government Resolution No. 1164/2016, which approved the Czech Republic's participation in the Central European Fund of Funds (SFF) managed by the European Investment Fund (EIF) through the Bank, the Bank in December 2017 signed a contract with the EIF and the Ministry of Industry and Trade (MPO), fulfilling this. From the total CZK 240 million of the Czech Republic's participation, no fulfilment from these contracts was received in 2017; however, a subsidy from the Ministry of Industry and Trade of CZK 2.5 million was received in the first quarter of 2018. Further drawings will take place gradually, based on the individual SFF requirements.

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

3.1. Interest income

CZKm	2017	2016
Interest income on loans and advances to banks	12	7
Interest income on loans and advances to customers	104	151
Interest on loans granted to the government institutions	122	178
Interest on debt securities	269	312
- held for trading	-	1
- designated at fair value through profit or loss	18	28
- available for sale	143	157
- held to maturity	108	126
Interest income	**507**	**648**
Interest on short sales	6	2
Interest on amounts due to banks	(116)	(173)
Interest on deposits due to customers	(4)	(8)
Interest on deposits from government institutions	(34)	(49)
Interest from unwinding discounts on provisions (Note 3.6)	(47)	(49)
Interest expenses	**(195)**	**(277)**
Net interest income	**312**	**371**

Interest income includes CZK 95 million (2016: CZK 138 million) of interest income on impaired financial assets.

3.2. Fee and commission income

CZKm	2017	2016
Fees from financial guarantees	220	246
Credit related fees and commissions	38	32
Fees and commissions from payment transactions	35	45
Fee and commission income	**293**	**323**
Fee and commission expense from trading activities	(2)	(2)
Fee and commission expense	**(2)**	**(2)**
Net fee and commission income	**291**	**321**

3.3. Gains and losses from financial operations

CZKm	2017	2016
Gains and (losses) on securities	(2)	22
- available for sale	22	34
- amounts reclassified from other comprehensive income on disposal	22	34
- changes in fair value of securities held for trading	(13)	6
- changes in fair value of securities designated at fair value through profit or loss	(25)	(17)
- gain on revaluation of short sales	9	(1)
- held to maturity	5	-
Net gains/ (losses) on derivatives held for trading	(51)	(23)
Net gains/ (losses) on hedging derivatives	(1)	6
Exchange differences (including exchange differences on available for sale and held to maturity debt securities)	59	2
Total income and expenses on financial operations	**5**	**7**

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 3 million in 2017 (2016: CZK 4 million).

3.4. Administrative expenses

CZKm	2017	2016
Wages, salaries and bonuses	(184)	(183)
Social security costs	(54)	(52)
of which: state pension scheme contributions	(37)	(36)
Total personnel expenses	**(238)**	**(235)**
General administrative expenses	(107)	(116)
Total administrative expenses	**(345)**	**(351)**

Wages, salaries and key management compensations:

CZKm	2017	2016
Wages and salaries of the Bank's employees	(120)	(111)
Key management personnel compensation	(48)	(56)
- wages and salaries of the Bank's management	(29)	(29)
- compensations to Board of Directors members	(16)	(25)
- compensations to Supervisory Board members	(2)	(1)
- compensation to Audit Committee members	(1)	(1)
Other employees' expenses	(9)	(9)
Social fund expenditures	(7)	(7)
Total wages, salaries and bonuses	**(184)**	**(183)**

Staff Analysis

	2017	2016
Number of members of the Board of Directors	3	5
Number of members of the Supervisory Board	8	9
Number of members of the Audit Committee	3	3
Average number of the Bank's management	17	18
Average number of Bank's employees (excl. above listed)	194	192

Other administrative expenses comprise:

CZKm	2017	2016
General administrative expenses	(69)	(73)
Rental charges	(6)	(6)
Audit, legal, tax and other professional services	(7)	(6)
Depreciation and amortization	(25)	(31)
Total other administrative expenses	**(107)**	**(116)**

3.5. Increase in loan impairment and write-offs

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

31 December 2017

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions/Disposals to loan impairment allowances	(282)	13	(269)
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	**(283)**	**13**	**(270)**

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)**

Reconciliation of the allowance account for impairment:

Year ended 31 December 2017

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2017	1,797	67	1,864
Additions/Disposals to impairment allowances	282	(13)	269
Use of the allowances for write-offs	(182)	-	(182)
Balance **at 31 December 2017**	**1,897**	**54**	**1,951**

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**

3.6. Provisions for guarantees and other provisions

The balance of provisions for guarantees and other provisions comprises:

CZKm	31 December 2017	31 December 2016
Provisions for guarantees (Note 3.22)	3,167	3,132
Provisions for loan commitments (Note 3.22)	15	1
Other provisions	32	32
Total provisions	**3,214**	**3,165**

Reconciliation of the provisions for guarantees and other provisions:

CZKm	2017	2016
Balance at 1 January	3,165	3,124
Increase/(decrease) in provisions for guarantees and loan commitments	2	525
Increase/(decrease) in other provisions	-	(533)
Interest expense from unwinding discounts (Note 3.1)	47	49
Balance at 31 December	**3,214**	**3,165**

In 2017, it consisted of:

- A provision for the annual contribution to the Resolution Fund of CZK 30 million (as at 31 December 2016: CZK 58 million, of which CZK 28 million was created for the contribution paid in 2016). Together with the payment to the Resolution Fund a provision of CZK 28 million (31 December 2016: CZK 138 million) was used, remaining part of the created reserve in amount MCZK 2 was released. The rest (CZK 30 million) will be used as a contribution for 2018 based on the actual amount stated by the CNB.

The decrease in other provisions in 2016 comprised mainly release of provision for a legal dispute of CZK 467 million connected to MISORA HOLDINGS LIMITED.

3.7. Income taxes

CZKm	2017	2016
Profit or loss before income tax	(34)	159
Theoretical tax calculated at a statutory income tax rate 2017: 19% (2016: 19%)	(6)	30
Non-taxable income from securities –permanent difference	(1)	(1)
Effect of non-recognized contingent deferred tax asset	109	110
Share of profit of equity-accounted investees	(2)	-
Other items	(59)	-
Income tax expense as reported in income statement	41	139
- current	41	37
- deferred	-	102
Income tax paid during the year	48	73
Current income tax assets at 31 December	7	36
Current income tax liabilities at 31 December	-	-
Effective tax rate	**(121)%**	**87%**

Deferred taxation

The recognized deferred tax can be analyzed as follows:

CZKm	31 December 2017	31 December 2016
Other provisions	12	13
Deferred tax recognized in other comprehensive income for revaluation of available for sale securities	(72)	(142)
Total deferred tax	**(60)**	**(129)**

CZKm	31 December 2017	31 December 2016
Deferred tax reported in the statement of financial position		
- to be recovered after more than 12 months	-	-
- to be recovered within 12 months	12	13
Deferred tax recognized in other comprehensive income for revaluation of available for sale securities		
- to be recovered within 12 months	**(72)**	**(142)**
Total deferred tax	**(60)**	**(129)**

Potential deferred tax asset of CZK 512 million as at 31 December 2017 (2016: CZK 403 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	2017	2016
Deferred tax balance at 1 January	(129)	(35)
Movement through income statement	-	(102)
Movement in deferred tax recognized in other comprehensive income for revaluation of available for sale securities	69	8
Deferred tax balance at 31 December	**(60)**	**(129)**

The deferred tax is calculated at the statutory income tax rate of 19% (31 December 2016: 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 2017	31 December 2016
Obligatory minimum reserves	77	-
Cash in hand	7	8
Loans provided to CNB	180	-
Total cash in hand and balances with central banks	**264**	**8**

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

3.9. Loans and advances banks

CZKm	31 December 2017	31 December 2016
Current accounts with other banks	4	8
Included in cash and cash equivalents (Note 3.21.)	4	8
Other amounts due from banks	**78**	**78**
Total loans and advances to banks	**82**	**86**

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 2017	31 December 2016
Government bonds – domestic	-	-
Securities held for trading	-	-
Government bonds – domestic	-	339
Government bonds – foreign	173	190
Bonds issued by Czech financial institutions	-	-
Securities designated at fair value through profit or loss	173	529
Total securities at fair value through profit or loss	**173**	**529**

3.11. Loans and advances to customers

CZKm	31 December 2017	31 December 2016
Loans to private legal entities and individuals	3,399	3,778
Loans to the Ministry of Finance and other government entities	2,541	4,279
Loans to municipalities	389	498
Gross amounts due from customers	**6,329**	**8,555**
Provisions for loans to customers (Note 3.5)	(1,951)	(1,864)
Net amounts due from customers	**4,378**	**6,691**

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 2017		31 December 2016	
	Assets	Liabilities	Assets	Liabilities
	CZKm	CZKm	CZKm	CZKm
CZK – principal	1,037	1,037	1,806	1,806
CZK – accrued interest	1	1	1	1
EUR – principal	1,486	1,486	2,442	2,442
EUR – accrued interest	17	17	30	30
Total	**2,541**	**2,541**	**4,279**	**4,279**

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

Equity instruments

CZKm	31 December 2017	31 December 2016
Equity instruments	32	-

In 2017, the Bank purchased three European Investment Fund shares at a total nominal value of EUR 3 000 000 from the European Investment Bank and, similarly as a number of other developing banks and institutions, became an EIF minority shareholder. The cost of shares amounted to EUR 1,280,858.04.

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

CZKm	31 December 2017	31 December 2016
Fixed income debt securities	3,769	4,715
Variable yield debt securities	9,927	10,114
Total debt securities available for sale	**13,696**	**14,829**

All AFS securities as at 31 December 2017 and 2016 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 0 million (2016: CZK 862 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 the borrower also has an obligation to return it.

AFS securities have been issued by the following issuers:

CZKm	31 December 2017	31 December 2016
- Czech state institutions	10,822	11,573
- Czech local government institutions	478	510
- Czech financial institutions	826	944
- Other Czech entities	181	186
- Foreign financial institutions	1,176	1,396
- Other foreign entities	213	220
Total debt securities available for sale	**13,696**	**14,829**

3.13. Financial assets held to maturity

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

CZKm	31 December 2017	31 December 2016
Czech state institutions	4,608	5,145
Total debt securities held to maturity	**4,608**	**5,145**

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 (2016: CZK 0 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 2017	31 December 2016
Financial assets		
Accrued income	30	37
Non-financial assets		
Prepaid expenses	12	12
Other	14	21
Total other assets, gross	56	70
Impairment provisions	(9)	(8)
Total other assets, net	**47**	**62**

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 2017 and 2016.

Shareholders' structure	31 December 2017	31 December 2016
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 2017 and for the year then ended	24	12	24	4	2
At 31 December 2016 and for the year then ended	221	108	221	(1)	-

In 2017 MUFIS a.s. paid out a dividend to the Bank in the amount of CZK 98 million.

3.16. Property, plant and equipmen

CZKm	Land	Buildings	Equipment and fittings	Total
At 1 January 2016				
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**
Year ended 31 December 2017				
Opening net book value	10	101	13	124
Additions	-	4	12	16
Disposals	-	-	(9)	(9)
Depreciation charge	-	(7)	(6)	(13)
Closing net book value	**10**	**98**	**10**	**118**
At 31 December 2017				
Acquisition cost	10	314	84	407
Accumulated depreciation	-	(216)	(74)	(290)
Net book value	**10**	**98**	**10**	**118**

3.17. Deposits from bank

CZKm	31 December 2017	31 December 2016
Due to other banks	3,527	5,672
Repo operations with other banks	-	863
Received term deposits from other banks	171	314
Amounts due to banks	**3,698**	**6,849**

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 3,527 million at 31 December 2017 (31 December 2016: CZK 5,672 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 2017	31 December 2016
Current accounts	1,596	1,467
Term deposits	1,758	4,855
Loans received	49	44
Guarantee deposits	5,597	2,639
Other payables to clients	1,748	2,258
Total	**10,748**	**11,263**

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

CZKm	31 December 2017	31 December 2016
Amounts due to state institutions	8,157	5,899
Amounts due to municipalities	96	62
Amounts due to other customers	2,495	5,302
Total amounts due to customers	**10,748**	**11,263**

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 2017	31 December 2016
Funding from the providers of the individual support programs not yet returned	6,251	2,720
Funds deposited by the program partners to cover risks attached to providing the financial guarantees *	1,990	2,011

* Risk coverage funds for programs Panel and Nový Panel in the amount of CZK 969 million (2016: CZK 969 million) are booked in off balance.

3.19. Other liabilities

CZKm	31 December 2017	31 December 2016
Payable to employees	20	32
Deferred income	311	460
- financial guarantees premium deferred income	294	440
- other deferred income	17	20
Accrued expenses (financial liability)	41	39
Amount payable to Ministry for Regional Development in respect to intermediation of the support program (financial liability)	160	179
Other	23	23
Total accruals and other liabilities	**555**	**733**

3.20. Equity and profit allocation

Share capital

		31 December 2017		31 December 2016	
	Nominal value of 1 share (CZK)	Number of shares	Value of shares	Number of shares	Value of shares
	(CZKm)	(pcs.)	(CZKm)	(pcs.)	(CZKm)
Share capital	239 500	10 988	2,632	10 988	2,632

In 2016 the share capital of Českomoravská záruční a rozvojová banka, a.s. was increased by the amount of CZK 500 million. The shares were underwritten by a monetary contribution by existing shareholders.

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 2017 and 2016 can by analyzed as follows:

	2017	2016
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

	2017	2016
	%	%
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 net loss of the Bank for the year ended 31 December 2017 is proposed to be allocated and net profit for 2016 of the Bank was allocated as follows:

CZKm	**2017**	**2016**
Allocated to retained earnings	(75)	9
Other funds created from the profit *	-	11
Net profit or loss per statutory financial statements	**(75)**	**20**

* 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 200 million.

3.21. Cash and cash equivalents

CZKm	31 December 2017	31 December 2016
Cash and balances with central banks (Note 3.8.)	264	8
Loans and advances to banks (Note 3.9.)	4	8
Total	**268**	**16**

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 2017	31 December 2016
Total issued financial guarantees	18,622	18,922
Loan commitments issued to clients	413	203
Total financial guarantees and loan commitments	**19,035**	**19,125**

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 2017 and 31 December 2016.

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 2017	31 December 2016
Assets	**18,622**	**22,011**
Czech state	17,983	21,355
Associates	1	1
Key management	-	-
Other related parties	638	655
Liabilities	**8,691**	**7,822**
Czech state	7,497	5,113
Associates	24	220
Key management	10	13
Other related parties	1,160	2,476
Revenues	**485**	**561**
Czech state	414	473
Associates	-	-
Key management	-	-
Other related parties	71	88
Expenses	**25**	**34**
Czech state	4	5
Associates	-	-
Key management	19	27
Other related parties	2	2
Collaterals received under reverse repo transactions and other off-balance sheet liabilities in the normal course of business	**1,666**	**1,665**
Czech state	692	690
Other related parties	974	975

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 37 million (2016: 44 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 2017 and 2016.

	31 December 2017	31 December 2016
Assets		
Amounts due from banks	0.08%	0.05%
Loans to customers	3.32%	3.22%
Available for sale securities	0.87%	1.27%
Securities at fair value through profit or loss	4.00%	5.00%
Securities held to maturity	3.58%	3.61%
Liabilities		
Amounts due to banks *	-0.16%	0.08%
Amounts due to customers	0.03%	0.03%
Repo operations with the Ministry of Finance	0.14%	0.04%

* Negative average effective interest rate relates to negative rate set by the ECB. ECB creates rate basis for market rates.

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 credit worthiness 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. Credit worthiness 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 2017

CZKm Classes of financial assets	**Risk category 4, 5**	**6**	**7**	**8**	**9**	**10**	**Not specified**	**Total**
Loans to private legal entities and individuals	34	218	45	7	-	-	21	325
Loans to Czech government entities	2,541	-	-	-	-	-	-	2,541
Loans to municipalities	-	151	-	-	-	-	-	151
Total	**2,574**	**369**	**45**	**7**	**-**	**-**	**21**	**3,017**

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**

Analysis of financial assets that are individually determined to be impaired

31 December 2017

CZKm Classes of financial assets	**Risk category 7**	**8**	**9**	**10**	**Not specified**	**Total**
Loans to private legal entities and individuals	629	223	170	1,089	963	3,074
Loans to municipalities	203	26	9	-	-	238
Total	**832**	**249**	**179**	**1,089**	**963**	**3,312**

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**

Analysis by regulatory rating

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

CZKm	Internal rating	31 December 2017	31 December 2016
Standard	4 – 6	2,942	4,770
Watched	7	899	1,163
Substandard	8	257	368
Doubtful	9	179	273
Loss	10	2,052	1,981
Total		**6,329**	**8,555**
Impairment provision for loans to customers (Note 3.5)		(1,951)	(1,864)
Net amounts due from customers		**4,378**	**6,691**

Analysis of provisions by risk category

CZKm		31 December 2017		31 December 2016	
Risk category		Type of provision		Type of provision	
		Individual	Portfolio	Individual	Portfolio
4 – 6	Standard	-	16	-	20
7	Watched	109	11	144	16
8	Sub-standard	66	-	93	-
9	Doubtful	72	-	116	-
10	Loss	1,677	-	1,475	-
Total		**1,924**	**27**	**1,828**	**36**
Total provisions			**1,951**		**1,864**

Analysis by collateral

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

CZKm	31 December 2017	31 December 2016
Bank guarantees and collateral by reliable guarantors	719	716
Cash collateral	5	7
Real estate collateral	544	956
Other loan collateral	54	58
Uncollateralized	5,007	6,818
Total	**6,329**	**8,555**
Impairment provision for loans to customers (Note 3.5)	(1,951)	(1,864)
Net amounts due from customers	**4,378**	**6,691**

Renegotiated loans to customers

CZKm	31 December 2017	31 December 2016
Loans to private legal entities and individuals	71	174

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

As at 31 December 2017 the balance of loans past due which were not classified as individually impaired were CZK 0 million (2016: 0 million).

ab) Quality of guarantees portfolio

31 December 2017 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	-	5	43	31	14	-	46	-	139
PANEL small portfolio guarantees	-	26	72	3	9	-	4	163	277
PANEL individual investment guarantees	-	723	1,537	210	253	-	3	-	2,726
Other previously provided guarantees	-	-	-	-	-	-	-	-	
Vadium	-	-	46	-	-	-	-	-	46
Small portfolio guarantees for businessmen since 2007	-	-	15	50	1	-	-	290	356
Small portfolio guarantees without external risk enhancement	33	259	741	217	47	-	4	11,645	12,946
Individual investment and operating guarantees for small and medium sized enterprises since 2007	18	208	1,013	428	344	-	121	-	2,132
Total	**51**	**1,221**	**3,467**	**939**	**668**	**-**	**178**	**12,098**	**18,622**

* 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 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.

ac) Quality of Securities portfolio

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

31 December 2017

CZKm	AA- to AA+	A- to A+	Lower than A	Total
Securities at fair value through profit or loss	-	173	-	173
Equity instruments available for sale	-	-	32	32
Securities available for sale	969	11,916	811	13,696
Securities held to maturity	-	4,608	-	4,608
Total	**969**	**16,697**	**843**	**18,509**

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**

ad) Quality of derivatives portfolio

The derivatives portfolio as at 31 December 2017 and 2016 includes established banking counterparties (with external rating equivalent of AA+ to A).

b) Geographical concentration of assets

31 December 2017
Assets

CZKm	Czech Republic	European Union	Total
Cash and balances with central banks	264	-	264
Amounts due from banks	82	-	82
Securities at fair value through profit or loss	-	173	173
Positive fair values of financial derivative transactions	15	-	15
Loans and advances to customers	4,378	-	4,378
Equity instruments available for sale	-	32	32
Securities available for sale	12,307	1,389	13,696
Securities held to maturity	4,608	-	4,608
Other financial assets	30	-	30
Total financial assets	**21,684**	**1,594**	**23,278**
Non-financial assets	**169**	**-**	**169**
Total	**21,853**	**1,594**	**23,447**

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
Equity instruments available for sale	-	-	-
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**

c) The Bank's maximum credit risk exposure

31 December 2017 in CZKm

	Total exposure			Collateral held
	Assets	Financial guarantees and loan commitments	Total credit exposure	
Cash and balances with central banks	264	-	264	-
Amounts due from banks	82	-	82	-
Securities at fair value through profit or loss	173	-	173	-
Financial derivatives	15	-	15	-
Loans to customers	4,378	-	4,378	1,322
- Loans to private legal entities and individuals	1,502	-	1,502	1,137
- Loans to the Czech government entities	2,541	-	2,541	-
- Loans to municipalities	335	-	335	185
Equity instruments available for sale	32	-	32	-
Securities available for sale	13,696	-	13,696	-
Securities held to maturity	4,608	-	4,608	-
Other financial assets	30	-	30	-
Financial guarantees and loan commitments	**-**	**19,035**	**-**	**1,990**
Total financial assets	**23,278**	**19,035**	**42,313**	**3,312**
Non-financial assets	**169**			
Total assets	**23,447**			

31 December 2016 in CZKm

	Assets	Total exposure Financial guarantees and loan commitments	Total credit exposure	Collateral held
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**			

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

	31 December 2017		31 December 2016	
CZKm	**Notional value asset**	**Notional value liability**	**Notional value asset**	**Notional value liability**
Interest rate swaps	500	500	500	500
Currency and cross-currency swaps	1,063	1,066	1,445	1,388
Total	**1,563**	**1,566**	**1,945**	**1,888**

	31 December 2017		31 December 2016	
CZKm	**Positive fair value**	**Negative fair value**	**Positive fair value**	**Negative fair value**
Interest rate swaps	-	23	-	46
Currency swaps	15	35	80	47
Total	**15**	**58**	**80**	**93**

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 2017 Notional value asset	31 December 2017 Notional value liability	31 December 2016 Notional value asset	31 December 2016 Notional value liability
Cross currency swaps	111	125	144	154
Total	**111**	**125**	**144**	**154**

CZKm	31 December 2017 Positive fair value	31 December 2017 Negative fair value	31 December 2016 Positive fair value	31 December 2016 Negative fair value
Cross currency swaps	-	25	-	29
Total	**-**	**25**	**-**	**29**

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 2017

CZKm	CZK	EUR	USD	Total
Cash and balances with central bank	264	-	-	264
Amounts due from banks	79	2	1	82
Securities at fair value through profit or loss	-	173	-	173
Financial derivatives	15	-	-	15
Loans to customers, net	2,875	1,503	-	4,378
Equity instruments available for sale	-	32	-	32
Securities available for sale	13,433	263	-	13,696
Securities held to maturity	4,608	-	-	4,608
Other financial assets	30	-	-	30
Total financial assets	**21,304**	**1,973**	**1**	**23,278**
Non-financial assets	**169**	**-**	**-**	**169**
Total assets	**21,473**	**1,973**	**1**	**23,447**
Amounts due to banks	995	2,703	-	3,698
Amounts due to customers	10,667	81	-	10,748
Financial derivatives	83	-	-	83
Other financial liabilities	201	-	-	201
Total financial liabilities	**11,946**	**2,784**	**-**	**14,730**
Non-financial liabilities and equity	**8,708**	**9**		**8,717**
Total liabilities and equity	**20,654**	**2,793**	**-**	**23,447**
Statement of financial position net	819	(820)	1	-
Off-balance sheet derivatives notional position, net	-	876	-	-
Net position	**819**	**56**	**1**	**-**

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
Equity instruments available for sale	-	-	-	-
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**	**-**	**-**

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 2017 or 2016 as EUR was the only significant currency in which the Bank had open position as at that date (for open position amounts see above).

	2017	**2016**
	CZKm	**CZKm**
Sensitivity to changes in EUR rates		
Expected rate fluctuation,%	10%	10%
Open position	56	71
Effect on profit and loss	(23)	(22)
Effect on equity	26	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 2017

	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Non-specified	Total
	CZKm	CZKm	CZKm	CZKm	CZKm	CZKm
Cash and balances with central bank	257	-	-	-	7	264
Amounts due from banks	82	-	-	-	-	82
Securities at fair value through profit or loss	-	4	169	-	-	173
Financial derivatives	-	-	-	-	15	15
Loans to customers, net	554	705	2,334	313	472	4,378
Equity instruments available for sale	-	-	-	-	32	32
Securities available for sale	207	759	9,300	3,430	-	13,696
Securities held to maturity	-	-	1,841	2,767	-	4,608
Other financial assets	-	-	-	-	30	30
Total financial assets	**1,100**	**1,468**	**13,644**	**6,510**	**556**	**23,278**
Non-financial assets	**-**	**-**	**-**	**-**	**169**	**169**
Total	**1,100**	**1,468**	**13,644**	**6,510**	**725**	**23,447**
Amounts due to banks	939	659	2,025	99	(24)	3,698
Amounts due to customers	8,943	2	-	-	1,803	10,748
Financial derivatives	-	-	-	-	83	83
Other financial liabilities	-	-	-	-	201	201
Total financial liabilities	**9,882**	**661**	**2,025**	**99**	**2,063**	**14,730**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**8,717**	**8,717**
Total	**9,882**	**661**	**2,025**	**99**	**10,780**	**23,447**
Net interest position	**(8,782)**	**807**	**11,619**	**6,411**	**(10,055)**	**-**

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
Equity instruments available for sale	-	-	-	-	-	-
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)**	**-**

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 2017 Sensitivity/Impact	31 December 2016 Sensitivity/Impact	Comment
Assets			
Loans to customers	(61)	(86)	
Loans to banks	(2)	-	
Held to maturity securities	-	-	
			Only fixed interest rates securities in the portfolio
Available for sale securities	(78)	71	
Impact on equity reserve			
Available for sale securities	(219)	218	
Impact on profit and loss			
Financial derivatives	(47)	(76)	
Liabilities			
Due to banks	134	253	
Due to customers	2	5	
Financial derivatives	50	78	

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 2017

	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	Total
	CZKm	CZKm	CZKm	CZKm	CZKm	CZKm
Cash and balances with central bank	261	-	-	-	3	264
Amounts due from banks	4	-	-	-	78	82
Securities at fair value through profit or loss	-	4	169	-	-	173
Financial derivatives	-	-	14	1	-	15
Loans to customers, net	790	830	2,649	109	-	4,378
Equity instruments available for sale	-	-	-	-	32	32
Securities available for sale	207	759	9,300	3,430	-	13,696
Securities held to maturity	-	-	1,841	2,767	-	4,608
Other financial assets	23	-	-	-	7	30
Total financial assets	**1,285**	**1,593**	**13,973**	**6,307**	**120**	**23,278**
Non-financial assets	**6**	**5**	**-**	**-**	**158**	**169**
Total	**1,291**	**1,598**	**13,973**	**6,307**	**278**	**23,447**
Amounts due to banks	704	710	2,198	86	-	3,698
Amounts due to customers	3,379	5,599	49	1,721	-	10,748
Financial derivatives	23	5	55	-	-	83
Other financial liabilities	-	-	-	-	201	201
Total financial liabilities	**4,106**	**6,314**	**2,302**	**1,807**	**201**	**14,730**
Non-financial liabilities and equity	**294**	**1,235**	**948**	**1,034**	**5,206**	**8,717**
Total	**4,400**	**7,549**	**3,250**	**2,841**	**5,407**	**23,447**
Net liquidity exposure	**(3,109)**	**(5,951)**	**10,723**	**3,466**	**(5,129)**	**-**

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
Equity instruments available for sale	-	-	-	-	-	-
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)**	**-**

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 2017

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	537	777	2,334	134	3,782
Amounts due to customers	6,858	5	1,886	3,762	12,511

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

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 2017

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	-	(10)	(13)	-	(23)

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)

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 2017

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Cross-currency swaps:					
Cash inflows	79	237	758	135	1,209
Cash outflows	(74)	(265)	(809)	(137)	(1,285)

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)

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 15%. The Bank has implemented the standard approach for capital management which is in compliance with Basel II requirements.

CZKm	31 December 2017	31 December 2016
Tier 1 capital		
Share capital	2,632	2,632
Other reserves	1,150	1,150
Retained earnings (without profit for the current year, statutory non-consolidated)	766	756
Less: Values adjusting according to requirements for prudent valuation	(1)	(1)
Less: Intangible assets	(15)	(21)
Total qualifying Tier 1 capital	**4,532**	**4,516**
Total regulatory capital	**4,532**	**4,516**
Total risk weighted exposure	**21,071**	**22,667**
Capital ratio	**21,51%**	**19,93%**

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 2017 Carrying value	31 December 2017 Fair value	31 December 2016 Carrying value	31 December 2016 Fair value
Financial assets				
Cash and balances with central banks	264	264	8	8
Loan and advances to banks	82	82	86	86
Loans to customers	4,378	4,209	6,691	6,538
- *Loans to private legal entities and individuals*	1,502	1,440	1,981	1,977
- *Loans to the Czech government entities*	2,541	2,434	4,279	4,180
- *Loans to municipalities*	335	335	431	381
Securities held to maturity	4,608	4,661	5,145	5,594
Other financial assets	30	30	37	37
Financial liabilities				
Amounts due to banks	3,698	3,633	6,849	6,798
Amounts due to customers	10,748	10,304	11,263	11,190
Other financial liabilities	201	201	218	218

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.

The following table analyses financial instruments measured at fair value at the reporting date, by the level in fair value hierarchy into which the fair value measurements is categorized. The amounts are based on the values recognized in the statement of financial position.

31 December 2017	Level 1	Level 2	Level 3
Financial assets at fair value through profit and loss			
Financial assets held for trading			
Debt securities	-	-	-
Derivatives	-	15	-
Debt securities designated at fair value	173	-	
Financial assets available for sale			
Equity instruments	-	-	32
Debt securities	13,696	-	-
Total assets at fair value	**13,869**	**15**	**32**
Financial liabilities at fair value through profit and loss			
Derivatives held for trading	-	58	-
Hedging derivatives		25	-
Total liabilities at fair value	**-**	**88**	**-**

31 December 2016	Level 1	Level 2	Level 3
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	-	-
Financial assets available for sale			
Equity instruments	-	-	-
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**	**-**

There have been no reclassifications between the Levels during the presented periods.

Reconciliation of Level 3 fair value measurements

The following table shows a reconciliation from the beginning balances to the ending balances for the fair value measurements in Level 3 of the fair value hierarchy.

2017 CZKm	Equity instruments	Total
Balance at 1 January	-	-
Purchases	32	32
Settlements	-	-
Transfers into Level 3	-	-
Transfers out of Level 3	-	-
Balance at 31 December	**32**	**32**

6/ Subsequent events

No significant events having a material impact on the financial statements of the Bank for the year ended 31 December 2017 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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