ANNUAL REPORT

ČESKOMORAVSKÁ
ZÁRUČNÍ A ROZVOJOVÁ
BANKA, a. s.

Czech-Moravian Guarantee and Development Bank serves as the National Promotional Bank
of the Czech Republic. Its role is to provide financing for economic and social development of the country.
It offers preferential loans, guarantees and equity instruments financed from the national funds,
regional budgets as well as European funds.

Contents

Chairman's introduction

The year 2018 can be considered one of the most successful and key years in the history of the Czech-Moravian Guarantee and Development Bank - Českomoravská záruční a rozvojová banka, a.s. (hereinafter "Bank"). In supporting small and medium-sized enterprises, the Bank achieved the best results since its foundation in 1992. For the first time in its history, the Bank was successful in establishing collaboration in the administration of financial instruments financed from European Funds with state administration agencies other than the Ministries exercising shareholding rights in the Bank. The Bank began to fully fulfil its role of the national promotional bank whose primary mission is to support the Czech Republic's economic and social development. The Bank is more and more engaged in the use and promotion of financial instruments as a whole. Thanks to its employees' specific expertise, the Bank has gradually been evolving into a leader in financial instruments administration in the Czech Republic.

The long-term economic growth of the Czech Republic which was confirmed in 2018 has influenced positively the entrepreneurs' willingness to invest in their further development. The demand for the Bank's guarantee and loan schemes increased year on year. Last year, the Bank concluded the highest number of contracts for transactions with small and medium-sized enterprises in its history. With its products, the Bank assisted in implementation of 6,060 Czech entrepreneurs´ projects which received support worth over CZK 12.5 billion. Thus, compared to last year, the Bank increased the volume of transactions by over one third.

Besides the positive economic situation, the growth was contributed to also by growing interest rates on the banking market as well as by amendments made on an ongoing basis to the conditions governing the Bank's key programmes such as GUARANTEE 2015-2023 and EXPANSION. Also, the extension of the national guarantee programme in November 2017, when the conditions for enterprises based in and outside Prague were unified, manifested itself in its full scope. In addition to that, the programme was opened for medium-sized enterprises. Because of the growing demand for this type of product, the Bank arranged for another increase of the European Investment Fund's counter-guarantee in the second half of the year. Based on that, the Bank will be able to share the risks from the portfolio of Czech entrepreneurs' projects totalling CZK 18.5 billion and implemented across the entire Czech Republic, at least till the end of 2020.

The EXPANSION Programme was also modified several times during 2018. Access to the programme was provided to a wider group of businesses (including those operating in tourism, transportation, education, culture and other types of services), and the programme has been opened up to more project types. This covers for example the projects entailing property purchase or reconstruction element as a predominant one or the projects associated with means of transport acquisitions, or projects classified as special support-receiving activities (high-speed internet operation, calamity timber processing, drought combating).

Towards the end of 2018, the Bank reached an agreement with the Prague City Council for the formation and management of the INFIN 2018 Loan Fund. Based on the agreement, innovative businesses and enterprises with a short history will have an opportunity to draw upon financial instruments in the form of preferential loans from the Operational Programme "Prague - Growth Pole" to implement projects in the Capital City of Prague. The amount of CZK 400 million was allocated to the Programme.

At the same time, the Bank signed an agreement with the Ministry of Foreign Affairs to implement the Foreign Development Cooperation Guarantee Programme. The agreement pursues the goal of reduction of investment risks in developing markets and contribution to sustainable development.

Also, the Bank agreed with the Ministry of Industry and Trade on launching a guarantee scheme for the EXPANSION Programme to provide small and medium-sized enterprises with guarantees for operating and investment loans exceeding CZK 4 million.

All the three above mentioned programmes are to be launched in the first half of 2019.

The fundraising for the Central Europe Fund of Funds (CEFoF) was ended in 2018. The total amount for investments is EUR 97 million, including the Bank's investment of EUR 8.2 million. Besides the Bank and EIF, the investors include MFB (the Hungarian Development Bank), AWS (Austria), SEF (Slovenia), SIH (Slovakia) and the International Investment Bank.

The Bank deepened its cooperation also with other state administration agencies and thereby opened up the way to creating additional programmes for small and medium-sized enterprises. For example, the Ministry of Labour and Social Affairs and the Bank are working on the preparation of a programme of preferential loans to support social enterprises. The Ministry of the Environment has been considering involvement of the Bank in the programmes of support in the form of commercial loan guarantees for waste management businesses.

In cooperation with other state institutions focusing on support for small and medium-sized enterprises such as Czech Export Bank, Export Guarantee and Insurance Corporation, CzechTrade, CzechInvest, Czech Technology Agency, the Bank established the Czechia Team platform. The objective is to facilitate enterprises in gaining access to state support, whether by sharing best practices, creating linked product chains, or utilizing synergies from shared products and services to support Czech entrepreneurs.

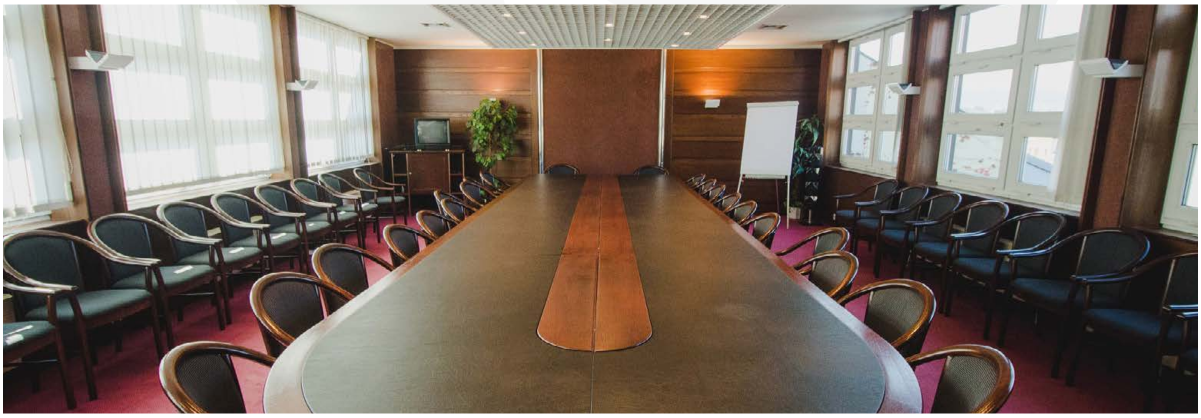
In addition, the Bank continued to be actively engaged in the activities of European associations of development or guarantee institutions such as ELTI, AECM and NEFI. This collaboration brings together the experience from providing support to entrepreneurs across individual countries and identifies challenges and opportunities in the use of EU financial instruments. Being active in the V4 platform, the Bank strengthens its position on the European financial market and within EU institutions.

Having once again raised its standards to a new level last year, the Bank will face a major challenge trying to push the bar even higher. Therefore, the Bank's primary goal for 2019 will be to strengthen and enhance cooperation with all the state administration agencies the Bank is currently working with on developing, launching and implementing new support programmes. Last but not least, the Bank wants to operate as a partner for Czech enterprises that need to be assisted in their development and to contribute so to the Czech Republic's economic growth in the long term horizon.

In 2018, the Bank achieved excellent business results through long-term cooperation with commercial banks and leasing companies, but also due to high-quality and professional work performed by former as well as current employees. I would therefore like to extend my sincere thanks to all of them.

I very much appreciate the efforts of the shareholder's representatives, which enabled us to fulfil the role of the national promotional bank and to contribute even more to the support given to Czech businesses and development of the Czech economy. I firmly believe that through our joined efforts in 2019 we will further expand our product range which will complement the commercial sector and will contribute to eliminating market failures and potential economic fluctuations.

Ing. Jiří Jirásek
Chairman of the Board of Directors



CMZRB as the national promotional bank of the Czech Republic

At the fall of 2014 beginning of 2015, the European Commission initiated its Investment Plan for Europe (so called the Juncker Plan). Based on the plan, the Commission put together collective and coordinated efforts to mobilise at least EUR 500 billion of public and private investments into the European economy within 2015–2020. To enhance the effect on investments, growth and employment, the Commission considered appropriate involving also national promotional banks into the process as they possess particular professional skills, knowledge of local circumstances, business and investor´s environment, as well as national policy and strategy. Member states having no such institutions were recommended to establish them to become actively involved in the Juncker Plan funding activities.

The Government of the Czech Republic reacted in 2016 by adopting its Resolution no. 919 on activation of Českomoravská záruční a rozvojová banka, a.s. as the national promotional bank, and in 2017 by its Resolution no. 547 declaring that CMZRB performs the role of the national promotional bank.

Since its establishment, in the frame of support to businesses, development of municipalities and infrastructure, the Bank has closely been cooperating with ministries exercising Bank shareholders´ rights, and among them mostly with the Ministry of Industry and Trade (MIT). As the national promotional bank, CMZRB strives for cooperation also with other partners considering the use of financial instruments in their programmes, namely those Operational Programmes financed from the ESI funds. The direct cooperation between the Bank and other authorities in the area of ESI funds is arising from the amendment to the Common Provisions Regulation (so called Omnibus) which entered into effect in August 2018.

Among those institutions which in 2018 exploited the opportunity of direct cooperation with the Bank, there are the Ministry of Foreign Affairs and the Capital City of Prague as they signed the agreement on administration of the guarantee fund of the Foreign Development Assistance, and the agreement on administration of the credit fund supporting start-ups and innovative businesses operating in the area of Prague, respectively. The commencement of the International Development Cooperation Guarantee and INFIN programmes is planned for the first half of 2019.

Other prospective partners using the services offered by CMZRB as the institution providing financial instruments in the frame of their programmes include the Ministry of the Environment (MoE) and the Ministry of Labour and Social Affairs (MLSA). There are negotiations on CMZRB´s involvement in the Operational Programme Environment in the form of guarantees for projects of waste management in process at present between the MoE and the Bank. The MLSA is considering the possibility of supporting social businesses via preferential loans through its Employment Operational Programme.

The programmes administered by CMZRB for the Ministry of Industry and Trade reported significant acceleration in providing both guarantees as well as loan instruments in 2018.

In relation to the increased interest in the GUARANTEE 2015–2023 programme, an agreement on the transfer of funds from older operational programmes and enhancement of this programme was reached with the MIT. And in July 2018, the EIF approved an increase of counter-guarantees in the frame of COSME facility which led to further GUARANTEE 2015–2023 capacity increase from existing CZK 10.5 billion to final CZK 18.5 billion, and the possibility for providing the product till the end of 2020 at least.

In the course of the last year, CMZRB also negotiated an adjustment of EXPANSION and ENERGY SAVINGS programme conditions with the Ministry of Industry and Trade. It consisted of increased capacities and simplified terms of use, resulting in more intensive utilization of these programmes, especially the EXPANSION one.

CMZRB continued its intensive collaboration with the European Investment Bank (EIB) in the area of supporting small and middle-sized enterprises, the 3 Seas Initiative, V4 funds as well as energy savings. Namely, in relation to energy savings CMZRB agreed with the EIB entering into a consultancy agreement. It will result in measures focusing on savings of funds in public and private spheres contributing so to meeting the Czech commitments in the area of energy efficient measures implementation.

Being one of the European Investment Fund shareholders, CMZRB expanded its cooperation with the Fund in the area of equity investments in the frame of the Central Europe Fund of Funds (CEFoF). The Fund aims at supporting growing innovative SMEs in Central European countries using venture capital.

For 2019, the Bank has prepared a range of new programmes, such as EXPANSION-GUARANTEES providing investment and working capital loans up to CZK 25 mil. It was launched already in the mid of February. Besides that, CMZRB together with the Ministry of Industry and Trade and the City of Ostrava prepares a programme focusing on revitalisation of brownfields in the area of the Ostrava City agglomeration as a part of PROPERTY OPEIC programme (Nemovitosti OPPIK).

Not only thanks to these new activities, but also due to opportunities of future months and years, the Bank as the powerful institution and knowledge centre in the sphere of financial instruments turns to be a strong partner for government institutions, and the national promotional bank of the CR for the existing as well as future programming periods after 2020.

Economic environment and its impact on the Bank´s performance

The global recovery of economic growth in developed economies has probably reached its peak, and the economic performance has been slowed down continuously. The growth of global trade has been slowed down even faster which is partially caused by an increasing tension in the global business relations and may affect also the Czech economy in the future (for instance, an economic impact related to Brexit).

Czech Republic's economic growth copies the global trend; nevertheless it still achieves very positive results. Pursuant to Czech Statistical Office's updated outlook as of the beginning of March 2019 the growth of the gross domestic product (GDP) reached 3% in 2018. Growing investments of businesses investing mainly to machinery and equipment, and government expenditures into transport infrastructure were the main factors of the year-on-year growth.

With respect to expected setback in the external environment, the Ministry of Finance has reduced its prediction of the Czech Republic's GDP growth dynamics for 2019 to 2.5% and for 2020 to 2.4% (source: MoF CR, 30 January 2019).

Similarly to 2017, the CR continued to hold its special position with respect to the unemployment rate not only among the EU states, but also in the global perspective. The unemployment rate fell to 2.2% in 2018, i.e. it was even lower than in 2017 when it reached its historical minimum.

In January 2019, the Fitch Ratings agency confirmed an excellent rating of the Czech Republic AA– with a stable outlook, and appraised so the high credit reliability of the Czech Republic. The trust in the Czech Republic is based mainly on strong public finances, external stability and robust banking sector.

The 2018 state budget ended in a surplus of CZK 2.9 billion which is the second best result since 1996. Compared to 2017 balance, the result is by CZK 9.1 billion better, and compared to the deficit approved for 2018 it is better by CZK 52.9 billion.

2018 year witnessed a continuous growth of repo rate starting at 0.75% at the beginning of the year up to 1.75% at the year end. This gradually growing trend brought an increase in demand for Bank´s products as its result, both in the area of guarantees provided as well as the new loan instruments launched. In total, we can say that 2018 year was the most successful year in the Bank´s history of providing support to businesses, and total growth of its business activities was for more than one third higher than in 2017.

Changes and impulses from the external environment have made the Bank´s internal and external processes, and the conditions under which the Bank operates, more demanding. In coming years, CMZRB, along with the entire banking sector, will need to deal with the increased cost burdens related to implementation of the Czech National Bank´s regulation on certain requirements for the system of internal principles, procedures and control measures against the legitimisation of the proceeds of crime and financing of terrorism, so called AML Regulation, and continuing implementation of measures aiming at personal data protection. The future position of CMZRB will be also influenced significantly by its involvement in the new programming period after 2020, for which the Bank started preparing already in 2018.

Bank´s Governing Bodies

Board of Directors

Chairman	Jiří Jirásek
Members	Ivan Duda
	Ivo Škrabal

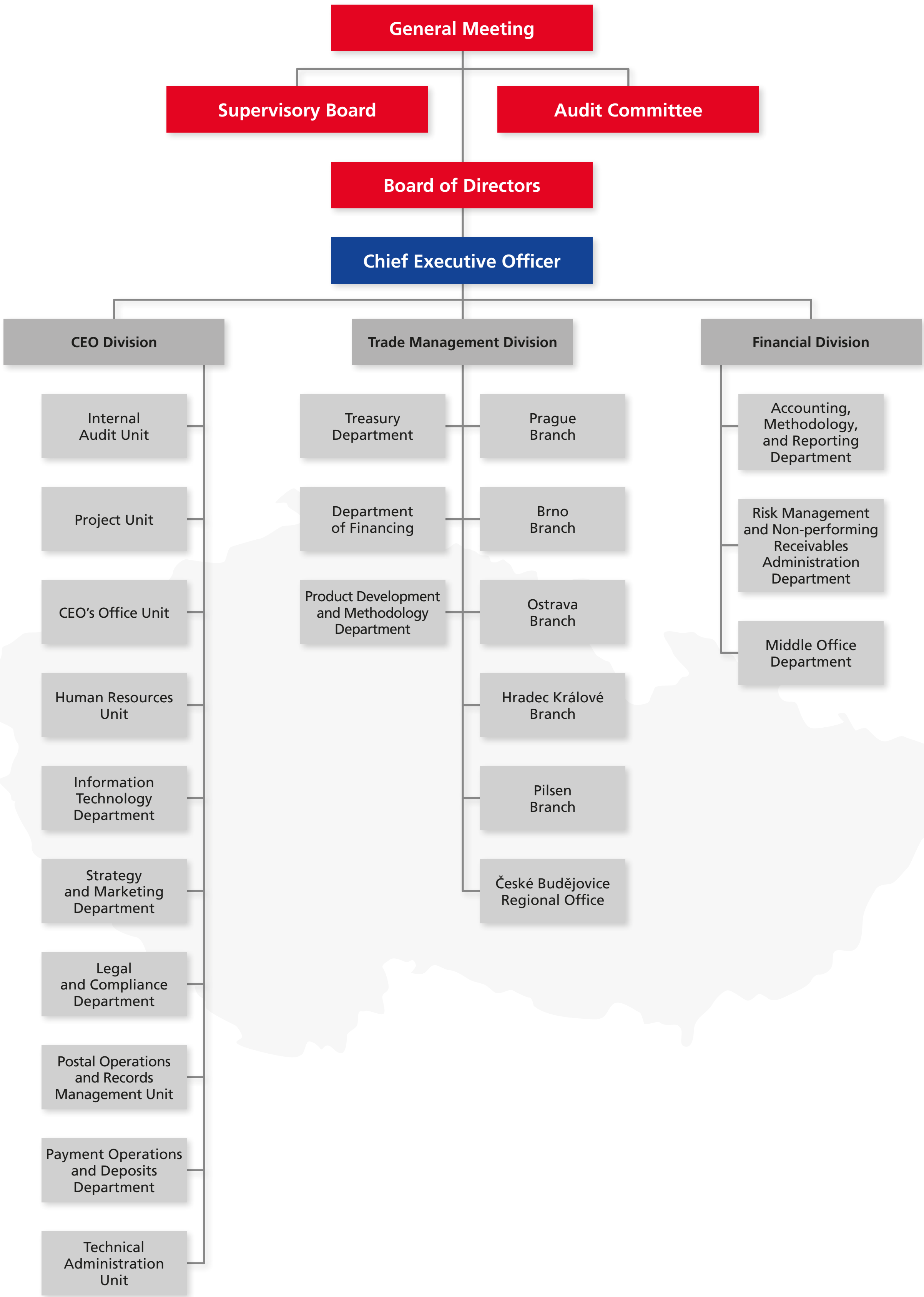
Supervisory Board

Chairman	Robert Szurman (Chairman till 28. 4. 2018, member from 29. 4. 2018 to 11. 6. 2018, Chairman from 12. 6. 2018)
Vice-Chairman	Pavel Závitkovský
Members	Lenka Dupáková
	Ladislav Koděra (till 5. 8. 2018)
	Marie Kotrlá (from 23. 1. 2018)
	Olga Nebeská (born Letáčková)
	Zdeněk Mareš (till 5. 8. 2018)
	Tomáš Novotný (till 24. 4. 2018)
	Luděk Šrein (till 9. 10. 2018)

Audit Committee

Chairman	Milan Novák
Vice-Chairman	Pavel Závitkovský
Member	Tomáš Hlivka

Bank’s organization chart



Report of the Board of Directors on the Bank's business activities and financial situation for 2018

Economic results

Basic economic characteristics of the Bank for 2014-2018

		Unit	2014	2015	2016	2017	2018
Balance sheet total		CZK mil.	127,337	30,999	27,612	23,436	24,105
Assets:	Deposits and loans at banks	CZK mil.	91,060	261	78	262	661
	Securities accepted by the Czech National Bank for refinancing	CZK mil.	9,946	10,474	16,195	15,430	16,886
	Debt securities	CZK mil.	13,929	10,703	4,308	3,047	2,145
	Payments from guarantees and other classified receivables	CZK mil.	3,082	2,477	1,942	1,452	1,725
Liabilities and equity:	Shareholder's equity	CZK mil.	4,695	4,875	5,359	5,086	4,861
	Liabilities	CZK mil.	122,642	26,124	22,253	18,350	19,244
	of which: reserves	CZK mil.	2,909	3,124	3,165	3,214	3,338
	funds to cover credit risks	CZK mil.	2,341	2,659	2,011	1,990	2,212
Off-balance sheet:	Guarantees granted	CZK mil.	17,900	19,926	18,922	18,622	19,863
Total revenues		CZK mil.	2,969	2,785	2,453	2,023	2,376
of which:	interests from securities and interbank operations	CZK mil.	426	376	319	269	318
	interests from operations with clients	CZK mil.	568	454	329	226	164
	revenues from fees and commissions	CZK mil.	457	388	323	293	285
Total expenses		CZK mil.	2,707	2,589	2,425	1,994	2,348
of which:	net impairment allowances and provisions	CZK mil.	382	331	102	319	214
Profit after tax		CZK mil.	262	196	28	29	28
Capital ratio		%	17.1	18.5	19.9	21.5	22.3

2018 proved to be a record-breaking year for the Bank in terms of new transactions. The volume of new transactions in 2018 was CZK 12.6 billion (in 2017: CZK 9.4 billion), of which CZK 1.5 billion was generated through loan transactions and CZK 11.1 billion through guarantee transactions. Similarly to previous years, the guarantee transactions were financed predominantly from the Bank's own resources and those of the programme's contracting authority (the Ministry of Industry and Trade) for financing the costs of preferential guarantees within a programme supporting small and medium-sized enterprises. The loan transactions were financed mostly from the European Structural and Investments Funds within the EXPANSION programme. The total value of the guarantee and loan transaction portfolios increased by 9.2% to CZK 22.3 billion; of that, the value of the guarantee transaction portfolio grew by 6.7% to CZK19.9 billion.

The decline in revenues from business activities continued in 2018, in particular, due to changes in the Bank's pricing policy (since the middle of 2012, the prices of newly provided loans and guarantees have not included profit), decreasing share of assets with higher interest rates revenues due to their gradual repayment, and non-interest revenues from programmes newly provided since 2018 which were increasing only gradually. The final net profit after taxation in amount of CZK 28 million is in accordance with the shareholder-approved policy for net profit generating which does not set net profit creation as a primary target for the Bank's financial performance. Shareholder's equity decreased from CZK 5.1 billion to CZK 4.9 billion year on year due to the decrease of valuation differences from securities at fair value against OCI by CZK 267 million. The capital ratio stood at 22.3% as of 31 December 2018, which is 0.8 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 92.8% of capital was allocated to risk coverage related to this type of risk. As of the end of 2018, all expected credit risk losses were fully covered by impairment allowances and provisions in an amount corresponding to IFRS 9, and the total balance of impairment allowances and provisions for credit risk was CZK 5.1 billion (i.e., 22.8% of the value of the guarantee and loan portfolio). Credit risks associated with certain types of guarantee products were covered by credit risks funds provided by programme originators in a total value of CZK 2.21 billion. As of the end of the year, moreover, the Bank had at its disposal the reserve funds in shareholder's equity amounting to CZK 1.35 billion.

The overall balance sheet at the end of 2018 was higher by 2.9%, and reached CZK 24.1 billion. Liabilities due to financial institutions diminished by CZK 1.4 billion, amounts due to clients increased by CZK 2.4 billion, other liabilities and deferred income by CZK 0.1 billion and valuation differences by CZK 0.2 billion. On the assets side, amounts due from clients were lower by CZK 0.2 billion, values of bonds went up by CZK 0.6 billion, other assets decreased by CZK 0.1 billion, and receivables from banks went up by CZK 0.4 billion. The balance sheet total does not include bank guarantees issued for loans to small and medium-sized enterprises which comprise a significant part of the Bank's business activities and credit exposure. Their value was CZK 19.9 billion as of the end of 2018.

On the assets side, the Bank had a portfolio of financial investments amounting to CZK 19.7 billion (81.8% of net assets) and placed predominantly into state bonds and bonds of selected banks and companies (79.0% of net assets). Important net assets items comprise loans provided to state institutions (6.7% of net assets) and loans to other clients (10.3% of net assets) as reported in loans and advances to customers. Non-earning assets represented 0.8% of the total balance sheet.

The funding sources on the liabilities and equity side were provided primarily by amounts due to customers - programme originators (54.5% of liabilities and equity) and banks (9.6% of liabilities and equity), shareholders' equity (20.2% of liabilities and equity), provisions (13.8% of liabilities and equity), as well as temporary and other liabilities.

Determination of capital ratio and other additional indicators

Indicator	Unit	2014	2015	2016	2017	2018
Tier 1 (T1) capital	CZK'000	**3,867,425**	**4,012,794**	**4,516,436**	**4,532,379**	**4,541,561**
Common equity tier 1 (CET1) capital	CZK'000	**3,867,425**	**4,012,794**	**4,516,436**	**4,532,379**	**4,541,561**
Instruments eligible for CET1 capital	CZK'000	**1,355,628**	**2,131,550**	**2,631,626**	**2,631,626**	**2,631,626**
Paid-in CET1 instruments	CZK'000	**2,131,550**	**2,131,550**	**2,631,626**	**2,631,626**	**2,631,626**
Acquired own CET1 instruments	CZK'000	**–775,922**	0	0	0	0
Own CET1 instruments acquired directly	CZK'000	–775,922	0	0	0	0
Retained earnings/accumulated losses	CZK'000	**1,413,018**	**756,011**	**756,011**	**765,925**	**774,639**
Retained earnings/accumulated losses from previous years	CZK'000	1,413,018	756,011	756,011	765,925	774,639
Accumulated other comprehensive income	CZK'000	514,099	640,738	0	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	**–18,546**	**–1,425**	**–732**	**–271**	**–232**
Value adjustments pursuant to prudential revaluation requirements	CZK'000	–18,546	–1,425	–732	–271	–232
Other intangible assets	CZK'000	**–32,675**	**–23,342**	**–20,469**	**–14,901**	**–14,472**
Other intangible assets – gross value	CZK'000	–32,675	–23,342	–20,469	–14,901	–14,472
Other transitional adjustments to CET1 capital	CZK'000	–514,099	–640,738	0	0	0
Tier 2 (T2) capital	CZK'000	0	0	0	0	0
Capital	CZK'000	**3,867,425**	**4,012,794**	**4,516,436**	**4,532,379**	**4,541,561**

Indicator	Unit	2014	2015	2016	2017	2018
Total risk exposure	CZK'000	**22,563,626**	**21,734,647**	**22,666,565**	**21,070,912**	**20,358,363**
Total risk-weighted exposures relating to credit risk pursuant to Standardised Approach	CZK'000	**18,765,897**	**18,830,208**	**20,583,545**	**19,377,445**	**18,864,652**
Exposures to central governments and banks	CZK'000	31,084	0	0	0	219,451
Exposures to regional governments and local bodies	CZK'000	205,584	194,933	168,033	159,126	150,382
Exposures to public sector entities	CZK'000	0	0	0	0	15,061
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	1,114,966	976,616	776,680	652,756	375,317
Exposures to enterprises	CZK'000	14,904,965	14,596,311	17,342,648	16,571,663	16,131,928
Exposures to retail	CZK'000	1,428,522	1,953,670	71,936	108,255	477,295
Exposures secured by property	CZK'000	156,394	130,822	90,453	60,051	34,564
Exposures in default	CZK'000	493,518	618,619	827,920	774,117	697,747
High-risk exposures	CZK'000	0	0	1,017,563	757,278	554,561
Exposures in covered bonds	CZK'000	144,034	62,779	61,462	40,124	0
Exposures to institutions and enterprises with short-term credit evaluation	CZK'000	77,467	98,978	39,436	39,640	26,912
Collective investment instruments	CZK'000	0	0	0	0	0
Equities	CZK'000	1,347	1,347	1,347	49,964	51,426
Other exposures	CZK'000	208,016	196,133	186,067	164,471	130,008
Risk exposure relating to position, foreign exchange and commodity risk pursuant to the Standard Approach	CZK'000	**592,813**	**102,907**	**0**	**0**	**1,850**
Tradable debt instruments	CZK'000	592,813	102,907	0	0	1,850
Currency transactions	CZK'000	0	0	0	0	0
Total risk exposure relating to operations risk	CZK'000	**2,909,928**	**2,678,764**	**1,945,764**	**1,636,305**	**1,456,254**
Operational risk – basic indicator approach	CZK'000	2,909,928	2,678,764	1,945,764	1,636,305	1,456,254
Total risk exposure relating to revaluation adjustments to credit risk	CZK'000	294,988	122,768	137,256	57,162	35,607
Standardised Approach	CZK'000	294,988	122,768	137,256	57,162	35,607

Capital ratio for Tier 1 equity capital	%	17.14	18.46	19.93	21.51	22.31
Capital ratio for Tier 1 capital	%	17.14	18.46	19.93	21.51	22.31
Capital ratio for total capital	%	17.14	18.46	19.93	21.51	22.31
Indicator	Unit	2014	2015	2016	2017	2018
Return of average assets (ROAA) [1]	%	0.35	0.24	0.04	0.10	0.11
Return on average equity (ROAE) [1]	%	6.81	5.01	0.68	0.63	0.61
Assets per employee [1]	CZK'000	595,033	148,322	130,246	110,027	112,639
Administrative costs per employee [1]	CZK'000	1,455	1,438	1,474	1,471	1,524
Net profit per employee [1]	CZK'000	1,226	939	130	134	130

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

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 2018 and 31 December 2017, thus providing complete reconciliation of individual regulatory capital lines with the institution's capital and the balance sheet.

As of 31 December 2018	Regulatory capital CZK'000	Shareholder's equity CZK'000
Paid-in share capital entered in the Commercial Register	2,631,626	2,631,626
(–) Capital investments into own instruments	–	–
Retained earnings from previous periods	774,639	774,639
Profit for the period	–	27,744
Accumulated other comprehensive income	–	77,029
Other reserve funds	1,150,000	1,350,000
(–) Value adjustments pursuant to prudential revaluation requirements	–232	–
(–) Intangible assets other than goodwill	–14,472	–
(–) Adjustments relating to unrealised gains and losses	–	–
Total capital eligible for inclusion into Tier 1	**4,541,561**	
Total shareholder's equity		**4,861,038**
Total Tier 2 capital	0	
Capital relevant for calculating large exposure limits, qualified participation limits and capital ratio	**4,541,561**	

As of 31 December 2018	Regulatory capital CZK'000	Shareholder's equity CZK'000
Paid-in share capital entered in the Commercial Register	2,631,626	2,631,626
(–) Capital investments into own instruments	–	–
Retained earnings from previous periods	765,926	765,926
Profit for the period	0	28,532
Accumulated other comprehensive income	–	309,657
Other reserve funds	1,150,000	1,350,000
(–) Value adjustments pursuant to prudential revaluation requirements	–271	–
(–) Intangible assets other than goodwill	–14,902	–
(–) Adjustments relating to unrealised gains and losses	–	–
Total capital eligible for inclusion into Tier 1	**4,532,379**	
Total shareholder's equity		**5,085,741**
Total Tier 2 capital	0	
Capital relevant for calculating large exposure limits, qualified participation limits and capital ratio	**4,532,379**	

The Bank's business activities in 2018

1. Product overview

During 2018, the Bank provided the following products:

a) **Guarantees**

- **GUARANTEE 2015-2023 Programme:**
    - A portfolio guarantee for bank loans up to CZK 4 million and to as much as 70% of the loan principal for small and medium-sized enterprises;
    - An individual guarantee for bank loans to as much as 80% of the loan principal for social enterprises (small and medium-sized), with the 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.
- **VADIUM Programme** – a guarantee for tender bids for small and medium-sized enterprises in the amounts from CZK 50,000 to CZK 5 million.

b) **Loans**

- **EXPANSION - LOANS Programme** – interest-free investment loans for small and medium-sized enterprises anywhere in the Czech Republic (except for the Capital City of Prague) in amounts up to CZK 45 million, with maturity up to 10 years and a commercial loan interest rate subsidy in amounts up to CZK 1 million. In case of special activities receiving this type of support (preferential region support, efficient industrial water use, high-speed internet access networks, timber processing - wood attacked by bark beetle), the limit for the loan is up to CZK 60 million and the interest rate subsidy amounts up to CZK 1.5 million.
- **ENERGY SAVINGS Programme** – preferential interest-free loans for enterprises of any size anywhere in the Czech Republic (except for the Capital City of Prague) with the objective of energy savings, namely in amounts up to CZK 30 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, with maturity up to 10 years, 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 preferential loan drawn.
- **Programme of Preferential Regional Loans for Small Enterprises in the South Bohemian Region** – loans for small enterprises in amounts up CZK 1 million with a fixed interest rate of 4% p.a. and a maturity up to 6 years.
- **Regional Development Fund** – long-term loans for municipalities or associations of municipalities (except for the Capital City of Prague) to co-finance projects for improving local infrastructure for business and non-business purposes, namely in amounts up to CZK 30 million, with a preferential fixed or variable interest rate determined individually according to current market conditions, with 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, namely up to CZK 130 million with a fixed or variable interest rate determined individually according to current market conditions, maturity up to 15 years, and a grace period up to 3 years.

2. Support to small and medium-sized enterprises

a) Overall results

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

The Bank's key guarantee program for SMEs in 2018 was again the GUARANTEE 2015-2023 Programme which was launched in February 2015.

The programme was mainly comprised of guarantees for working capital loans provided in a number twice as high as investment guarantees.

The results of this programme implementation (especially after its expansion from the end of 2017) confirmed increasing interest in the use of the guarantees in 2018. In addition to using national resources, the GUARANTEE 2015-2023 Programme is co-financed also 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 2018. Loans guaranteed by the Bank are provided by Česká spořitelna, a.s.

The Bank's main programme of loans for SMEs in 2018 was again the EXPANSION - LOANS Programme which was launched in June 2017. The programme has been implemented as part of the Operational Programme Entrepreneurship and Innovations for Competitiveness and will be in operation until the end of the programming period in 2023. The programme conditions were amended several times during 2018, and these changes had a major impact on small and medium-sized enterprises' growing interest in obtaining a loan from the this programme.

ENERG Programme and ENERGY SAVINGS Programme were the other loan programmes in 2018. Their objective is to contribute to the reduction of energy consumption.

Based on an agreement with the Regional Authority of South Bohemia, SMEs (including start-ups) were provided with preferential loans for financing projects implemented in the region.

The loans and guarantees were provided predominantly to small enterprises with up to 49 employees (see table 1).

Table 1 Supported projects divided according to the sizes of enterprises

Number of employees	Guarantees				Loans			
	Number		Amount		Number		Amount	
		%	mio CZK	%		%	mio CZK	%
0 to 9	3,158	55	5,225.7	47	78	30	369.5	25.6
10 to 49	2,515	44	5,686.6	52	117	46	649.3	45.1
50 to 249	48	1	131.8	1	59	24	421.2	29.3
TOTAL	**5,721**	**100**	**11,044.1**	**100.0**	**254**	**100.0**	**1,440.0**	**100.0**

b) Guarantees

Based on guarantee contracts concluded in 2018, the Bank provided 5,721 guarantees totalling to CZK 11,044 million. The guarantees supported loans of CZK 17,263 million (see table 2).

Table 2 Guarantees issued and loans guaranteed (excl. guarantees under the VADIUM Programme)

INDICATOR		2014	2015	2016	2017	2018
Guarantees issued	Number	3,273	4,307	3,972	4,368	5,721
Amount of guarantees issued	mio CZK	7,627	10,894	8,819	8,950	11,044
Amount of loans guaranteed	mio CZK	10,895	15,564	12,598	12,791	17,263
Average guarantee coverage	%	70	70	70	70	64

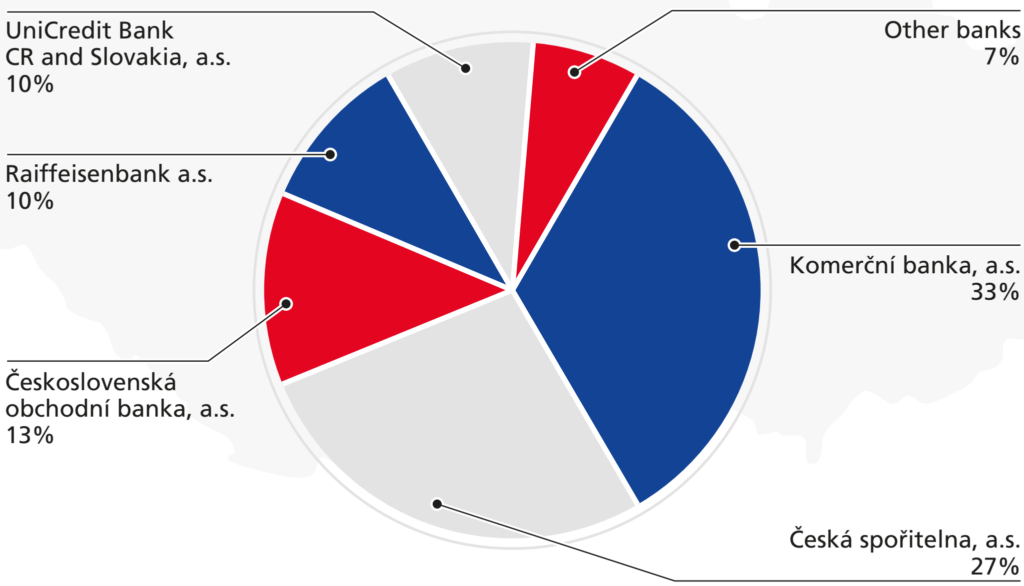
The largest proportions of the guarantees were used to support projects in the Moravian-Silesian Region and the South Moravian Region (see table 3).

Table 3 Regional structure of guarantees provided
(in % of contracted value of guarantees issued)

REGION		2014	2015	2016	2017	2018
Capital City of Prague	%	14.2	14.7	30.9	26.1	13.6
Central Bohemia	%	10.6	10.2	8.0	6.8	8.8
South Bohemia	%	5.9	7.5	4.4	5.1	5.5
Pilsen	%	4.7	5.6	4.6	4.3	4.1
Karlovy Vary	%	1.1	1.4	0.9	1.6	1.1
Ústí nad Labem	%	2.8	3.3	2.5	3.3	3.2
Liberec	%	3.3	3.1	2.0	3.7	3.7
Hradec Králové	%	4.6	6.2	3.8	4.7	4.5
Pardubice	%	4.1	4.1	3.8	4.6	5.2
Bohemian-Moravian Highlands	%	3.1	3.2	3.3	3.5	2.9
South Moravia	%	13.1	12.8	13.0	11.0	15.7
Olomouc	%	8.0	7.3	5.0	6.4	7.5
Zlín	%	4.7	5.2	5.4	4.9	5.8
Moravia-Silesia	%	19.8	15.4	12.4	14.0	18.5
TOTAL	**%**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

During 2018, the guaranteed transactions were predominantly concluded with Komerční banka, a.s., and Česká spořitelna, a.s.

Graph 1 Guarantee transactions structure in 2018 by lending banks



The largest number of guarantees was provided to projects in trade, followed by manufacturing (see table 4).

Table 4 Sector structure of guarantees provided in 2018
(in % of contracted value of issued guarantees)

Trade	55.4%
Manufacturing	21.0%
Construction	12.1%
Accommodation and food service activities	2.8%
Transportation	2.8%
Other manufacturing	0.8%
Health services	0.7%
Services	0.7%
Other business activities	3.7%
TOTAL	**100.0%**

c) Loans

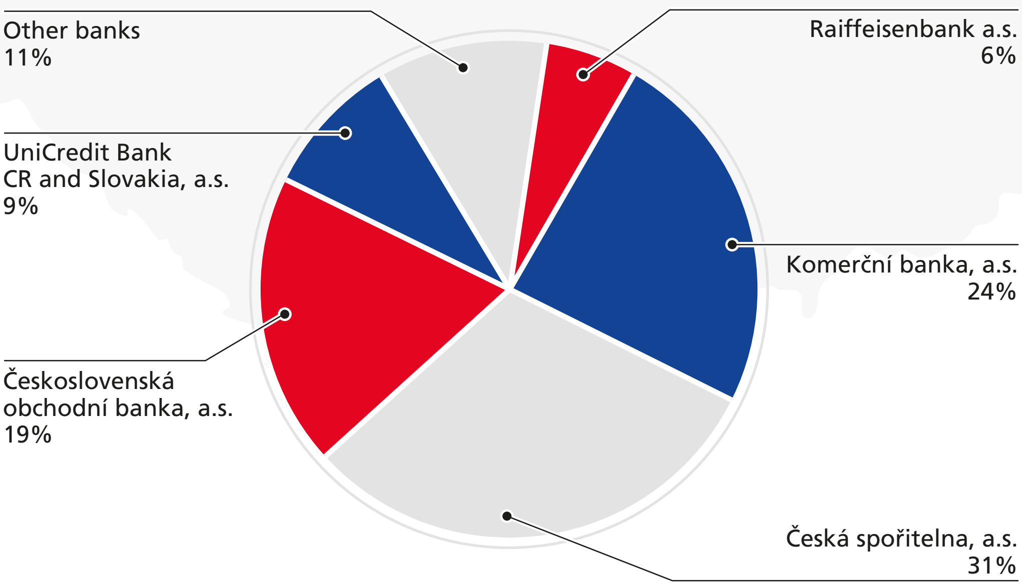
During 2018, the Bank provided the business sector with 254 loans in the total volume of CZK 1,440 million.

Table 5 Preferential loans provided

INDICATOR		2014	2015	2016	2017	2018
Loans provided	Number	36	27	9	56	254
Amount of loans guaranteed	mio CZK	86.3	65.3	7.0	357.0	1,440.0
Average guarantee coverage	mio CZK	2.3	2.4	0.8	6.4	5.8

In the EXPANSION Programme, 237 loan contracts were concluded totalling CZK 1,420.8 million. Within the programme, the Bank cooperated mostly with Česká spořitelna, a.s., Komerční banka, a.s., and Československá obchodní banka, a.s.

Graph 2 Co-financing structure in the EXPANSION Programme by lending banks



UniCredit Leasing CZ, a.s. and ČSOB Leasing, a.s. were the leasing companies with the largest proportion of co-financing provided within the programme.

A total of 17 loans worth CZK 19.3 million was provided in other loan programmes (ENERG, ENERGY SAVINGS, Southern Bohemian).

Table 6 Sectoral structure of loans provided
(in % of contracted value of loans issued)

Manufacturing	56.2%
Trade	17.1%
Transportation	5.3%
Construction	5.1%
Accommodation and food service activities	2.3%
Other manufacturing	0.6%
Services	0.2%
Health services	0.1%
Other business activities	13.1%
TOTAL	**100.0%**

3. Support for reconstructing apartment houses

In 2018, the Bank administered a total of 8,642 Contracts on Providing Grants to Cover Loan Interest (of 10,122 contracts originally concluded). On the basis of these, the Bank paid out over CZK 761 million. From the start of the programme in support of apartment house reconstructions to the end of 2018, grant recipients were collectively paid the total of CZK 10,243 million, which comprises 75% of the total volume of concluded Contracts on Providing Grants to Cover Loan Interests (CZK 13,664 million).

In 2018 the Bank also administered a portfolio of bank loan guarantees enabling owners or co-owners of apartment houses to obtain loans for their repairs. As of the end of 2018, the portfolio consisted of 1,177 bank loan guarantees (of which 99 were portfolio guarantees), and the outstanding balance of the guaranteed loans principal amount was CZK 2,543 million).

4. Financing municipal infrastructure

Loans from the Regional Development Fund are designed for projects aimed at transportation and technical infrastructure, construction of real estate for business activities, as well as sport, cultural and educational facilities. These loans are provided only as an additional service complementing the overall portfolio of services. In 2018, the Bank provided 3 loans totalling CZK 39.7 million.

5. Trading on financial markets

In 2018, the Bank was active on the money and capital markets. The main purpose was to manage its liquidity, administer its portfolio of bonds, manage interest-rate and currency risks and refinance the lending programme for supporting SMEs and municipalities. The Bank used money market instruments, and derivative operations to manage the interest-rate and currency risks. In administering its portfolio of bonds and money market instruments, the Bank again maintained its conservative investment strategy and was oriented exclusively to purchasing government bonds, treasury bills and bonds of a selected group of issuers with high credit risk ratings.

6. Other lending activities

As a financial manager for infrastructure programmes, the Bank secured financing for these programmes in amount of CZK 625 million during 2018. The said financing comprised resources from the State Fund for Transport Infrastructure and was designated for Czech motorway projects, comprising construction of the Lovosice – Ústí nad Labem section of the D8 motorway and the Osičky – Hradec Králové section of the D11 motorway.

In 2018, 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 almost CZK 10 million to 85 beneficiaries). Since the start of the interest rate subsidies administration programme in 2009, the total volume of disbursed interest rate subsidies reached CZK 220.4 million as of 31 December 2018.

7. Central Europe Fund of Funds

The fundraising for the Central Europe Fund of Funds (CEFoF) was ended in 2018. The total amount for investments is EUR 97 million, including the Bank's investment of EUR 8.2 million. Besides the Bank and EIF, the investors include MFB (the Hungarian Development Bank), AWS (Austria), SEF (Slovenia), SIH (Slovakia) and the International Investment Bank.

During 2018, contracts were concluded with managers of two out of the five funds selected. These two funds are Espira and Enern Tech Fund III. The managerial teams of both funds are composed of Czech or Czech and Slovak managers. The value of the companies receiving support developed positively during the year. The portfolio investments include famous Czech start-ups such as Velká pecka s.r.o. which operates Rohlik.cz, one of the best-known online supermarkets.

Report of the Supervisory Board of Českomoravská záruční a rozvojová banka, a.s., for 2018

In 2018 the Supervisory Board carried out its duties as defined by law and the Articles of Association of Českomoravská záruční a rozvojová banka, a.s. Being the Bank's oversight body, the Supervisory Board monitored the Board of Directors in discharging its duties and conducting Bank's business activities, its financial management and executing Bank's strategy. The Supervisory Board was regularly informed by the Bank's Board of Directors about the Bank's activities, its financial situation and other essential matters.

Having examined the financial statements as on 31 December 2018, and based upon the external auditor's report, the Supervisory Board states that Bank's accounting records and books were kept in a transparent manner and in compliance with generally binding accounting regulations for banks as well as with the Bank's Articles of Association. The accounting records and books reflect the Bank's financial situation in all important respects, and the financial statements produced on the basis of such accounting records present a true and fair view of the accounting and financial position of the Bank.

An audit of the Bank's financial statements was conducted by KPMG Česká republika Audit, s.r.o. and confirmed that the financial statements provide the true and fair view of the financial position of Českomoravská záruční a rozvojová banka, a.s. as on 31 December 2018 and of its operation in 2018 in compliance with Czech accounting regulations. The Supervisory Board acknowledged the auditor's report with consent.

The Supervisory Board has reviewed the financial statements and proposed distribution of profits for the 2018 accounting period. On the grounds of the facts stated above and pursuant to the applicable Articles of Association of Českomoravská záruční a rozvojová banka, a.s., the Supervisory Board recommends the sole shareholder exercising the powers of the General Meeting of Českomoravská záruční a rozvojová banka, a.s. to approve the regular financial statements and the proposed distribution of 2018 profits as presented by the Bank's Board of Directors.

The Supervisory Board also reviewed the Report on Relations between Related Entities for 2018 and reviewed the Bank's Annual Report for 2018. It recommends the sole shareholder exercising the powers of the General Meeting to approve these documents.

In Prague on 9 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., for 2018

In the course of 2018, the Audit Committee fulfilled its responsibilities and carried out its duties 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 the scope if its competence, the Audit Committee monitored in 2018 the process of compiling the Bank's financial statements for 2017 and their mandatory audit by the auditor - KPMG Česká republika Audit, s.r.o. The Committee dealt also with the plan as well as strategy of audit for the year 2018. Moreover, it assessed the independence of the audit firm KPMG Česká republika Audit, s.r.o. and the character of additional non-audit services provided by the external auditor, and came to the conclusion that on the basis of presented documents the external auditor may be regarded as independent. The external auditor also provided the Audit Committee with the 2017 MiFID report. Cooperation with the external auditor proceeded at a very good level the last year.

In compliance with the Act on Auditors, the Audit committee reviewed and approved the provision of non-audit services to the Bank by KPMG Česká republika, s.r.o., namely:

- Verification of data on liabilities for the purpose of calculating the level of contributions to the Crisis Resolution Fund by the auditor;
- Processing and submitting the Corporate Income Tax Return for 2018, providing tax consultancy related to actual tax issues.

In its regular meetings, the Audit Committee assessed the effectiveness of the Bank's management and control systems and the activities of the Bank's Internal Audit Unit, including its activity plans and particular audit events performed. The Audit Committee has stated that the systems established in the Bank are functional and efficient, and measures adopted in respect of audit findings are followed.

In the course of 2018, the Audit Committee reviewed the Report on the Information System Audit conducted by the audit firm Ernst & Young, s.r.o, as well as information about the present status and plans in the area of IT. The Audit Committee also reviewed and noted information on securing the integrity of accounting and financial reporting systems, final report on implementation of IFRS 9 and information on corrective measures in the area of AML.

Performing its function of the Risk Committee, the Audit Committee assessed the Bank's system of risk management; plan of remedial procedures and crisis resolution for the Bank; report on valuation of assets, liabilities and off-balance sheet items and their reflection in the offers to clients while taking into account the business model and strategies for risk management, as well as information about risks, capital, liquidity, and probability and timing of expected profit in the overall system of remuneration.

The Audit Committee produced and submitted its Report on Activities of the Audit Committee for 2017/2018 (monitored period 25 April 2017 – 24 April 2018) to the Public Audit Oversight Board in a new format.

The Chairman of the Audit Committee regularly informed the Bank's Supervisory Board about the results of the Audit Committee meetings.

In Prague on 26 March 2019

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

Milan Novák
Chairman of the Audit Committee

KPMG Česká republika Audit, s.r.o.
Pobřežní 1a
186 00 Praha 8
Czech Republic
+420 222 123 111
www.kpmg.cz

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

Opinion

We have audited the accompanying financial statements of Českomoravská záruční a rozvojová banka, a.s. ("the Company"), prepared in accordance with International Financial Reporting Standards as adopted by the European Union, which comprise the statement of financial position as at 31 December 2018, and the income statement, the statement of other 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 2018, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Basis for Opinion

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

KPMG Česká republika Audit, s.r.o., a Czech limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Recorded in the Commercial Register kept by the Municipal Court in Prague, Section C,

Identification No. 49619187
VAT CZ699001996
ID data box: 8h3gtra

KPMG

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

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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.

Prague
23 April 2019

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 2018
prepared in accordance with IFRS
as adopted by the EU

Income statement

	Note	Year ended 31 December 2018 CZKm	Year ended 31 December 2017 CZKm
Interest and similar income		568	507
Interest income calculated the effective–interest method		568	507
Interest and similar expenses		(194)	(195)
Net interest income	**3.1**	**374**	**312**
Fee and commission income		285	293
Fee and commission expenses		(2)	(2)
Net fee and commission income	**3.2**	**283**	**291**
Gains from financial operations	3.3	7	87
Losses on financial operations	3.3	(29)	(82)
Administrative expenses	3.4	(355)	(345)
Increase in loan impairment and write–offs	3.5	(73)	(270)
Increase in provisions for guarantees and other provisions	3.6	(111)	(3)
Other operating income		**(17)**	**(26)**
Operating profit or loss		**79**	**(36)**
Share of earnings in associates accounted for using the equity method	3.15	–	2
Profit or loss before income tax		**79**	**(34)**
Income tax expense	3.7	(60)	(41)
Profit or loss for the year		**19**	**(75)**

Statement of other comprehensive income

	Note	Year ended 31 December 2018 CZKm	Year ended 31 December 2017 CZKm
Profit or loss for the year		**19**	**(75)**
Other comprehensive income			
Valuation gains/(losses) on available–for–sale financial assets		(293)	(341)
Net gains/(losses) on FVOCI/AFS assets transferred to income statement on disposal	3.3	–	(22)
Deferred income tax relating to components of the comprehensive income	3.7	56	69
Change of loss allowances for debt securities against FVOCI		(30)	–
Other comprehensive income for the year, net of tax		(267)	(294)
Total comprehensive income		**(248)**	**(369)**

Statement of financial position

	Note	31 December 2018 CZKm	31 December 2017 CZKm
Assets			
Cash and balances with central banks	3.8	671	264
Loans and advances to banks	3.9	62	82
Financial assets held for trading			
– debt securities	3.10	–	–
– derivatives	4.2.2	13	15
Debt securities designated at fair value	3.10	168	173
Non–trading financial assets mandatorily at fair value through profit or loss			
– loans and advances to customers	3.11	31	–
Financial assets FVOCI (available for sale)			
– equity instruments	3.12	33	32
– debt securities	3.12	12,731	13,696
of which: assets pledged as collateral		–	–
Financial assets at amortized cost – debt securities (held to maturity)	3.13	6,132	4,608
of which: assets pledged as collateral			–
– loans and advances to customers	3.11	4,080	4,378
Current income tax assets	3.7	–	7
Investment in associate	3.15	12	12
Intangible assets		14	15
Property, plant and equipment	3.16	120	118
Other assets	3.14	48	47
Total assets		**24,115**	**23,447**
Liabilities			
Deposits from banks	3.17	2,318	3,698
Deposits from customers	3.18	13,126	10,748
Financial liabilities held for trading – derivatives	4.2	34	58
Hedging derivatives	4.2.2	16	25
Current income tax liabilities	3.7	18	–
Deferred tax liabilities	3.7	6	60
Provisions	3.6	3,338	3,214
Other liabilities	3.19	395	555
Total liabilities		**19,251**	**18,358**
Shareholders' equity			
Share capital	3.20	2,632	2,632
Statutory and other reserves		1,350	1,350
Revaluation reserve for FVOCI/AFS securities		77	310
Retained earnings		805	797
Total shareholders' equity		**4,864**	**5,089**
Total liabilities and shareholders' equity		**24,115**	**23,447**

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 9 April 2019.

Jiří Jirásek
Chairman of the Board

Ivan Duda
Member of the Board

Statement of changes in equity

	Share capital CZKm	Statutory and other reserves CZKm	Revaluation reserve for FVOCI/AFS securities CZKm	Retained earnings CZKm	Total CZKm
Balance at 1 January 2017	**2,632**	**1,150**	**641**	**1,052**	**4,975**
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**
Net impact of IFRS 9 implementation	–	–	34	(11)	23
Balance at 1 January 2018	**2,632**	**1,350**	**344**	**786**	**5,112**
Profit or loss for the period	–	–	–	19	19
Net fair value gains on FVOCI securities	–	–	(293)	–	(293)
Deferred income tax relating to components of other comprehensive income	–	–	56	–	56
Change of loss allowances for debt securities against FVOCI			(30)	–	(30)
Total comprehensive income	–	–	(267)	19	(248)
Balance at 31 December 2018	**2,632**	**1,350**	**77**	**805**	**4,864**

Statement of cash flows

	Note	2018 CZKm	2017 CZKm
Profit or loss before income tax		79	(34)
Adjustments for non–cash transactions			
Loans impairment and write–offs and provisions for guarantees	3.5, 3.6	184	273
Creation of provisions and adjustments for losses on securities		38	–
Depreciation and amortization	3.4	20	25
Share of profit of associates		–	(2)
Change in fair values and foreign exchange differences		(20)	(32)
Other non–cash items		24	12
Net interest income	3.1	(374)	(312)
Fee and commission income	3.2	(285)	(293)
Operating profit before changes in operating assets and liabilities		*(334)*	*(363)*
(Increase)/decrease in operating assets			
Loans and advances to banks	3.9	25	–
Loans and advances to customers	3.11	568	2,481
Other assets	3.14	(3)	358
Increase/(decrease) in operating liabilities			
Deposits from banks	3.17	(1,374)	(3,137)
Deposits from customers	3.18	2,377	(516)
Other liabilities	3.19	(116)	(61)
Interest received	3.1	522	560
Interest paid	3.1	(198)	(162)
Dividends received		–	98
Fee and commission received	3.2	192	144
Net cash flow from operating activities before income tax and payments under guarantee calls		*1,659*	*(598)*
Payments made under guarantee calls		(391)	(386)
Income taxes paid	3.7	(39)	(48)
Net cash flow from operating activities		***1,229***	***(1,032)***
Cash flows from investing activities			
Purchases of securities	3.12	(1,644)	(781)
Sales of securities and proceeds from matured securities	3.12	868	2,091
Purchase of tangible and intangible assets	3.16	(45)	(26)
Net cash flow from investing activities		***(821)***	***1 284***
Cash flows from financing activities			
Capital increase		–	–
Dividends paid		–	–
Net cash flow from financing activities		***–***	***–***
Net increase/ (decrease) in cash and cash equivalents		**408**	**252**
Cash and cash equivalents at the beginning of the year	**3.21**	**268**	**16**
Cash and cash equivalents at the end of the year	**3.21**	**676**	**268**

2018

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 2018

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 2018.

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 other 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 FVOCI 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 2018

The following revised standards effective from 1 January 2018 are mandatory and relevant for the Bank and have been applied by the Bank since 1 January 2018.

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.

The detailed impact of IFRS 9 implementation is disclosed in Note 2e.

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

Although the standards and interpretations provided below have been issued by the IASB, they are not effective for accounting period ending on or before 31 December 2018.The Bank has decided not to use the option of applying them early.

IFRS 16 Leasing

This standard will be mandatory for accounting periods beginning on or after 1 January 2019. Early application is permitted, if the entity also applies standard IFRS 15.

IFRS 16 replaces standard IAS 17 Leasing and related interpretations. The standard cancels the current dual accounting model for tenants and instead requires companies to report most of their rental contracts on the balance sheet according to one model, eliminating the difference between operating and finance leases.

Under IFRS 16 the contract is considered to be a lease if it gives the right to decide on the use of the asset over a period of time in exchange for consideration. In the case of such contracts, the new model requires the lessee to report the used asset and the lease liability. The used asset is depreciated and the related lease liability is interest-bearing. This will be reflected in the majority of leases by the decrease of the leased lease costs over the term of the lease, even if the lessee pays constant leasing instalments.

The new standard introduces several exemptions for the lessee from the scope that concern:

- leases with a lease term of 12 months or less without the purchase option at the end of the lease; and
- leases where the underlying asset is of low value.

The lessor's lease accounting remains largely unaffected after the introduction of the new standard and the difference between operating and finance lease will be maintained.

The Bank expects that the new standard will affect the consolidated financial statements at initial application, because the entity will have to disclose assets and liabilities in respect of operating leases under which the entity acts as the lessee in the consolidated statement of financial position. The expected impact of the initial application of IFRS 16 on the financial statements prepared in accordance with IFRS is the recognition of the Right of Use in the range of MCZK 16–17 and Lease liability in the similar amount.

Other accepted standards and interpretations issued but not effective for the current accounting period (the Bank does not expect significant impact)

Standards adopted by EU

Amendments to IFRS 9: Prepayment Features with Negative Compensation

In October 2017 the IASB issued "Amendments to IFRS 9 – Financial Instruments – Prepayment Features with Negative Compensation". The EU adopted these changes in March 2018 effective from 1 January 2019, which is consistent with the effective date set by the IASB.

Amendments adjusting the existing conditions of IFRS 9 apply to prepayment features upon early contract termination to enable measurement at amortised cost (or at fair value presented in other comprehensive income depending on the business model) also for negative compensation, i.e. if the borrower was permitted to prepay the instrument at an amount less than the unpaid principal and interest owed. According to these amendments, compensation can also be paid to the contractual party that effected the early payment. The calculation of the compensation payment must be the same for both sanctions for early repayment as well as for fee income on early repayment.

The Bank assessed the possible impact of these changes on the valuation of financial assets in its portfolio. As part of the assessment, the Bank's portfolio showed no instances of early repayment with

negative compensation; accordingly, it is expected that these changes will have no impact on the Bank's financial statements.

IFRIC 23 Uncertainty over Income Tax Treatments

IFRIC 23 clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities, whilst also aiming to enhance transparency. Under IFRIC 23, the key test is whether it is probable that the tax authority will accept the entity's chosen tax treatment. If it is probable that the tax authorities will accept the uncertain tax treatment then the tax amounts recorded in the financial statements are consistent with the tax return with no uncertainty reflected in measuring current and deferred taxes. Otherwise, the taxable income (or tax loss), tax bases and unused tax losses shall be determined in a way that better predicts the resolution of the uncertainty, using either the single most likely amount or expected (sum of probability weighted amounts) value. An entity must assume the tax authority will examine the position and will have full knowledge of all the relevant information.

The Bank does not expect that the interpretation, when initially applied, will have material impact on the financial statements as the Bank does not operate in a complex multinational tax environment and does not have material uncertain tax positions.

Standards not yet adopted by EU:

- Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures
- Amendments to IAS 19 Plan Amendment, Curtailment or Settlement
- Amendment to the Conceptual Framework for Financial Reporting
- Amendments to IFRS 17: Insurance Contracts
- Annual Improvements to IFRSs 2015–2017 Cycle
- Amendments to IFRS 3: Definition of a Business
- Amendments to References to the Conceptual Framework in IFRS Standards
- Amendments to IAS 1 and IAS 8: Definition of Material

(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 – effective until 31 December 2017

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.

(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.

(e) Financial assets and financial liabilities – policies effective from 1 January 2018

(i) Recognition and initial measurement

The Bank initially recognises selected financial assets and financial liabilities (e.g. receivables from clients, payables to clients, subordinated liabilities, etc.) on the date on which they are originated. All other financial instruments (including spot purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the financial instruments.

A financial asset or financial liability is measured initially at fair value adjusted for transaction costs. Transaction costs are incremental costs that are directly attributable to acquisition or issue.

(ii) Classification

Financial assets

At initial recognition, a financial asset is classified as measured at:

- amortised cost (AC);
- fair value through other comprehensive income (FVOCI);
- fair value through profit or loss (FVTPL).

A financial asset is measured at amortised cost (AC) if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (the so-called "SPPI test").

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

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (the so-called "SPPI test").

At initial recognition of an equity investment that is not held for trading, the Bank irrevocably elected to present subsequent changes in fair value in FVOCI. This election was made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

At initial recognition, the Bank designates a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise – see note 2e (vii).

Business model assessment

The Bank's business model reflects how groups of financial assets are managed together to achieve a particular business objective. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. The Bank considers all relevant information and evidence which is available at the assessment date. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the business model and financial assets held within this business model is evaluated and reported to the Bank's key management personnel;
- the risks that affect the performance of the business model and financial assets held within this business model, and how those risks are managed;
- how managers of the Bank are compensated; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. Information about sales activity is not considered in isolation, but as part of an overall assessment of how the entity's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment whether contractual cash flows are solely payments of principal and interest (the so-called "SPPI test")

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition, 'interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- early repayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets; and
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

Reclassification

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

Financial liabilities

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at:

- amortised cost (AC); or
- fair value through profit or loss (FVTPL).

(iii) Derecognition

Financial assets

The Bank derecognises a financial asset when

- the contractual rights to the cash flows from the financial asset expire, see note 2e (iv) below; or
- it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between

- the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and
- the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in equity

is recognised in profit or loss.

From 1 January 2018, any cumulative gain/loss recognised in equity in respect of equity securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities.

The Bank enters into transactions whereby it transfers assets recognised on its balance sheet, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

(iv) Modification of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised, see note 2e (iii), and a new financial asset is recognised at fair value.

If the cash flows of the modified asset at amortised cost are not substantially different, the modification does not result in derecognition of the financial asset. The Bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented in the income statement together with addition, release or utilisation of loss allowances. In other cases, the gain or loss is presented in the income statement together with interest income.

Financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognised in the income statement.

(v) Fair value measurement

"Fair value" is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When one is available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

The best evidence of the fair value of a financial instrument on initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received).

If an asset or liability measured at fair value has a bid price and an ask price, the Bank measures

- assets and long positions at a bid price;
- liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for the particular risk exposure. Portfolio-level adjustments (e.g. bid-ask adjustment or credit risk adjustments that reflect the measurement on the basis of the net exposure) are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

Fair value hierarchy

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

Level 1: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Bank can access at the measurement date.

Level 2: Level 2 inputs are inputs other than quoted prices included within level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices) for the asset or liability. This category includes instruments valued using:

- quoted market prices in active markets for similar instruments;
- quoted prices for identical or similar instruments in markets that are considered less than active; or
- other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3: Level 3 inputs are unobservable inputs. This category includes all instruments for which the valuation technique includes inputs that are not observable and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

(vi) Impairment

The Bank recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- loan commitments issued;
- financial guarantees issued.

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition.

The Bank considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of "Low credit risk".

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months from the reporting date.

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the Bank in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount of the financial asset and the present value of estimated future cash flows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the entity if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows:

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets measured at amortised cost and debt financial assets measured at FVOCI are credit-impaired. A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulties of the borrower or issuer;
- significant default in non-payment contractual conditions;
- a breach of contract such as a debtor’s default or past due event;
- the restructuring of a loan made by the Bank on terms that Bank entity would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower’s condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered impaired.

In making an assessment of whether an investment in bonds is credit-impaired, the Bank considers the following factors:

- the market's assessment of creditworthiness as reflected in the bond yields;
- the rating agencies' assessments of creditworthiness;
- the issuer's ability to access the capital markets for new debt issuance;
- the probability of the issuer being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.

Presentation of loss allowance for ECL in the balance sheet

Loss allowances for ECL are presented in the balance sheet as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally as a provision, except for as stated in the bullet point below;
- where a financial instrument includes both a drawn component (a financial asset) and an undrawn component (a loan commitment), and the Bank cannot separately identify the expected credit losses on the loan commitment component from those on the financial asset component, the expected credit losses on the loan commitment should be recognised together with the loss allowance for the financial asset. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be recognised as a provision;
- debt instruments measured at FVOCI: no loss allowance is recognised in assets in the balance sheet because these instruments are presented at their fair value in assets. However, the loss allowance is disclosed in the notes to the financial statements and is recognised in "Revaluation gains (losses)" in equity.

Loss allowances and provisions for ECL established by debiting expenses are recognised in "Write-offs, additions and use of loss allowances and provisions for receivables and guarantees" in the income statement. This item also includes any subsequent use of loss allowances.

The release of loss allowances no longer considered necessary is recognised in "Release of loss allowances and provisions for receivables and guarantees, income from written-off receivables" in the income statement.

Tax loss allowances

The tax-deductible portion of total loss allowances established in the accounting period for credit losses is calculated in accordance with Section 5 ("Banking reserves and loss allowances") and Section 8 ("Loss allowances for receivables from borrowers") of Act No. 593/1992 Coll., on Reserves, as amended. Loss allowances are recorded in sub-ledger accounts for the purpose of determining the tax liability.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

The write-off of receivables is recognised in "Write-offs, additions and use of loss allowances and provisions for receivables and guarantees" in the income statement. If a fully-provisioned receivable is written off, the loss allowance relating to the same item of the income statement is reduced by an identical amount. Income from loans previously written off is included in "Release of loss allowances and provisions for receivables and guarantees, income from written-off receivables" in the income statement.

(vii) Designation of a financial instrument at fair value through profit or loss (FVTPL)

Financial assets

At initial recognition, the Bank may designate some financial assets as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Financial liabilities

The Bank may, at initial recognition, designate some financial liabilities as measured at FVTPL because either:

- financial liabilities are managed, evaluated and reported internally on a fair value basis; or
- it eliminates or significantly reduces an accounting mismatch that would otherwise arise.

(f) Offsetting financial instruments – effective until 31 December 2017

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.

(g) 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.

(h) Impairment of financial assets – effective until 31 December 2017

(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.

(i) Sale and repurchase agreements – effective until 31 December 2017

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.

(j) 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'.

(k) 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. See Note 2e for more details regarding the methods of measurement of financial assets and liabilities and calculation of expected credit losses.

In 2017 the amount was determined in accordance with IAS 37 Provisions, Contingent liabilities and Contingent assets. Provisions for guarantees were made for estimated losses above the amounts deposited by the Czech state. These estimates were 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 was 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 was 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.

(l) 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.

(m) 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.

(n) 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.

(o) 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.

(p) 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.

(q) Key Bank's management judgments and estimates

The preparation of the financial statements in conformity with IFRS requires the Bank's management to make estimates and assumptions that affect the amounts of assets and liabilities reported at the balance sheet date, disclosures about contingent assets and liabilities, and income and expenses for the reporting period.

Estimates are primarily used to determine the fair value of financial instruments for which no active market exists, to measure intangible assets, to assess the impairment of assets, and to determine the amount of provisions. The Bank's management takes into account the information available at the balance sheet date, and actual results may differ from these estimates.

As of 1 January 2018, estimates and assumptions include the classification of financial assets. Financial assets are measured based on the selected business model and are assessed for SPPI (solely payments of principal and interest) criteria, i.e. whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Any significant growth in the credit risk of a financial asset since its initial recognition is newly assessed and future expectations for determining expected credit losses are also implemented.

Information about critical judgements and estimates in applying accounting policies that have the most significant effect on the amounts recognised in the Bank's financial statements is included in the following notes:

- deferred tax liability/asset – note 3.7
- net impairment loss on loans and receivables – note 3.5
- fair value of financial assets and liabilities – note 5

(r) 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.

(s) Effect of changes in accounting policies

Based on the Decree, from 1 January 2018 financial instruments have been reported, measured a disclosed in the notes to the financial statements in accordance with the International Financial Reporting Standards adjusted by directly applicable regulations of the European Union on applying the international accounting standards ("International Accounting Standards" or "IFRS").

Since 1 January 2018, the application of IFRS 9 Financial Instruments has had a major impact on the Bank with regard to the classification of receivables from customers and the calculation of credit losses (i.e. loss allowances). As a result of the application of IFRS 9, the Bank changed from the model of incurred losses to the model of expected losses.

For the purpose of classification, the Bank newly assesses the individual receivables from customers based on the:

- business model for managing the financial assets (i.e. the model under which the Bank manages its financial assets in order to collect cash flows); and
- characteristics of contractual cash flows following from the financial assets (i.e. whether the contractual terms of the financial asset give rise, on specific dates, to cash flows that are solely payments of principal and interest).

In determining the credit losses (i.e. loss allowances), the Bank divided the receivables from customers in three stages based both on quantitative and qualitative criteria:

- credit risk has not increased significantly since initial recognition (the so-called "stage 1");
- credit risk has increased significantly since initial recognition (the so-called "stage 2");
- credit impaired (the so-called "stage 3").

The new accounting policies applied to financial instruments are described in note 2 to these financial statements.

The impact of this change on equity as at 1 January 2018 is presented in the table part below.

i) Initial application of IFRS 9

Measurement categories

Classification of assets and liabilities at IFRS 9 first time adoption compared to IAS 39 classification at the end of 2017:

1 January 2018 MCZK	Note	Original classification under IAS 39 effective until 31/12/2017	New classification under IFRS 9	Original carrying amount under IAS 39 effective until 31/12/2017	New carrying amount under IFRS 9
Financial assets					
Cash and balances with central banks	3.8	Amortised cost	Amortised cost	264	264
Loans and advances to banks	3.9	Amortised cost	Amortised cost	82	81
Financial assets held for trading – derivatives	4.2.2	FVTPL	FVTPL	15	15
Debt securities designated at fair value	3.10	Designated as at FVTPL	Designated as at FVTPL	173	173
Non-trading financial assets mandatorily at fair value through profit or loss					
– loans and advances to customers	3.11	Amortised cost	Mandatorily measured at FVTPL	62	63
Financial assets FVOCI					
– equity instruments	3.12	AFS	FVOCI	32	32
– debt securities	3.12	AFS	FVOCI	13,696	13,696
Financial assets at amortized cost		Designated as at FVTPL	Designated as at FVTPL		
– debt securities	3.13	Amortised cost	Amortised cost	4,608	4,597
– loans and advances to customers	3.11	Amortised cost	Amortised cost	4,316	4,364
Investment in associate	3.15	Equity method	Equity method	12	12
Other assets at amortised cost	3.14	Amortised cost	Amortised cost	30	30
Total financial assets				**23,290**	**23,327**

1 January 2018 MCZK	Note	Original classification under IAS 39 effective until 31/12/2017	New classification under IFRS 9	Original carrying amount under IAS 39 effective until 31/12/2017	New carrying amount under IFRS 9
Financial liabilities					
Payables to banks	3.17	Amortised cost	Amortised cost	3,698	3,698
Payables to customers	3.18	Amortised cost	Amortised cost	10,748	10,748
Other liabilities	3.19	Amortised cost	Amortised cost	283	283
Provisions	3.6	Amortised cost	Amortised cost	3,182	3,195
Total financial liabilities				**17,911**	**17,924**

Significant accounting policies and procedures concerning the classification of financial instruments under IFRS 9 are described in Note 2. The result of the application of these accounting policies and procedures was the reclassification described in the tables above.

Receivables from customers of CZK 63 million are classified under IFRS 9 as mandatorily measured at FVTPL because they do not meet SPPI criteria and cannot be recorded at amortised cost.

Reconciliation of the carrying amounts of financial assets and liabilities

The following tables reconcile the carrying amounts of financial assets under the Decree effective until 31 December 2017 and under IFRS 9 as at 1 January 2018:

Financial assets at amortised cost

MCZK	Original carrying amount under IAS 39 effective until 31/12/2017	Reclassification	Remeasurement	New carrying amount under IFRS 9
Cash and balances with central banks				
Opening balance	264	–	–	264
Remeasurement	–	–	–	–
Closing balance	264	–	–	264
Financial assets at amortized cost – debt securities				
Opening balance	4,608	–	–	4,608
Remeasurement	–	–	(11)	(11)
Closing balance	4,608	–	(11)	4,597
Loans and advances to banks				
Opening balance	82	–	–	82
Remeasurement	–	–	(1)	(1)
Closing balance	82	–	(1)	(81)
Financial assets at amortized cost – loans and advances to customers				
Opening balance	4,378	–	–	4,378
Remeasurement	–	(62)	48	(14)
Closing balance	4,378	(62)	48	4,364
Other assets				
Opening balance	30	–	–	30
Remeasurement	–	–	–	–
Closing balance	30	–	–	30
Total amortised cost	**9,362**	**(62)**	**36**	**9,336**

FVOCI

MCZK	Original carrying amount under IAS 39 effective until 31/12/2017	Reclassification	Remeasurement	New carrying amount under IFRS 9
Available-for-sale securities				
Opening balance	13,728	–	–	13,728
To FVOCI	–	(13,728)	–	(13,728)
Closing balance	13,728	(13,728)	–	–
FVOCI – debt				
Debt securities				
Opening balance	–	–	–	–
From AFS (2017)	–	13,696	–	13,696
Closing balance	–	13,696	–	13,696
FVOCI – equity				
Equity securities				
Opening balance	–	–	–	–
From AFS (2017)	–	32	–	32
Closing balance	–	32	–	32
Total FVOCI	**13,728**	**13,728**	**–**	**13,728**

Financial assets at FVTPL

MCZK	Original carrying amount under IAS 39 effective until 31/12/2017	Reclassification	Remeasurement	New carrying amount under IFRS 9
Positive FV od derivatives	**15**	**–**	**–**	**15**
Receivables from customers				
Opening balance	–	–	–	–
From amortised cost	–	62	1	63
Closing balance	–	62	1	63
Debt securities	**173**	**–**	**–**	**173**
Total FVTPL	**188**	**62**	**1**	**251**

The following table reconciles the carrying amounts of financial liabilities under the Decree effective until 31 December 2017 and under IFRS 9 as at 1 January 2018:

	Original carrying amount under IAS 39 effective until 31/12/2017	Reclassification	Remeasurement	New carrying amount under IFRS 9
AMORTISED COST				
Payables to banks	3,698	–	–	3,698
Payables to customers	10,748	–	–	10,748
Other liabilities	283	–	–	283
Total amortised cost	**14,729**	**–**	**–**	**14,729**
FVTPL				
Negative FV of derivatives	83	–	–	83
Total FVTPL	**83**	**–**	**–**	**83**

Effects of the reclassification of financial assets and financial liabilities

As at 1 January 2018, the Bank did not carry out the reclassification of financial assets and financial liabilities under the Decree effective until 31 December 2017 to amortised cost under IFRS 9.

Net impact of transition to IFRS 9 on equity

The following table analyses the net impact of transition to IFRS 9 on revaluation gains (losses) and retained profits (or accumulated losses):

MCZK	Impact of adopting IFRS 9 as at 1/1/2018
Revaluation gains (losses)	
Closing balance as at 31/12/2017	310
Reclassification of debt securities from AFS to amortised cost	–
Reclassification of debt securities from AFS to FVTPL	–
Recognition of expected credit losses (ECL) under IFRS 9 for debt securities at FVOCI	34
Impact of deferred tax	–
Opening balance at 1/1/2018 (under IFRS 9)	**344**
Retained profits or accumulated losses	
Closing balance as at 31/12/2017	797
Reclassification under IFRS 9	(2)
Recognition of expected credit losses (ECL) under IFRS 9 including ECL for financial assets other than loan commitments and financial guarantee contracts	5
Recognition of expected credit losses (ECL) under IFRS 9 including ECL for loan commitments and financial guarantee contracts	(14)
Impact of deferred tax	–
Opening balance at 1/1/2018 (under IFRS 9)	**786**

Reconciliation of loss allowances and provisions

The following table reconciles:

- the closing balances of loss allowances to financial assets under the Decree effective until 31 December 2017 and provisions for loan commitments and financial guarantee contracts as at 31 December 2017;
- the opening balance of the loss allowances for expected credit losses (ECL) under IFRS 9 as at 1 January 2018:

CZKm	Original carrying amount under the Decree effective until 31/12/2017	Reclassification	Reneasurement	New carrying amount under IFRS 9
Receivables from banks from amortised cost to amortised cost	–	–	1	1
Debt securities from amortised cost to amortised cost	–	–	11	11
Receivables from customers from amortised cost to amortised cost	1,948	–	(48)	1,900
Receivables from customers from amortised cost to mandatorily measured at FVTPL	4	(4)	–	–
Other assets from amortised cost to amortised cost	9	–	–	9
Subtotal for financial assets measured at amortised cost	**1,961**	**(4)**	**(36)**	**1,921**
Debt securities from AFS to FVOCI	–	–	34	34
Loan commitments and financial guarantee contracts issued	3,182	–	14	3,196
Total	**5,143**	**(4)**	**12**	**5,151**

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

3.1 Interest income

CZKm	2018
Interest income on loans and advances to banks	86
Interest income on loans and advances to customers	82
Interest on loans granted to the government institutions	82
Interest on debt securities	318
– held for trading	1
– designated at fair value through profit or loss	7
– debt securities at FVOCI	182
– debt securities at amortised cost	128
Interest income	**568**
Interest on short sales	–
Interest on amounts due to banks	(90)
Interest on deposits due to customers	(28)
Interest on deposits from government institutions	(76)
Interest expenses	**(194)**
Net interest income	**374**

CZKm	2017
Interest income on loans and advances to banks	12
Interest income on loans and advances to customers	104
Interest on loans granted to the government institutions	122
Interest on debt securities	269
– held for trading	–
– designated at fair value through profit or loss	18
– available for sale	143
– held to maturity	108
Interest income	**507**
Interest on short sales	6
Interest on amounts due to banks	(116)
Interest on deposits due to customers	(4)
Interest on deposits from government institutions	(34)
Interest from unwinding discounts on provisions (Note 3.6)	(47)
Interest expenses	**(195)**
Net interest income	**312**

Until 31 December 2017, provisions were recognized in accordance with IAS 37. As at 1 January 2018, they are reported in accordance with IFRS 9 and the change of allowance related to discounting is recognized together with a change in the provision (Note 3.6).

Interest income and interest expense calculated in respect of the following items using the effective interest rate method amount as follows:

CZKm	2018
Financial assets measured at amortised cost	375
Financial assets at FVOCI	182
Financial assets, except for financial assets at FTVPL	**557**
Financial liabilities at amortised cost	**194**

3.2 Fee and commission income

CZKm	2018	2017
Fees from financial guarantees	223	220
Credit related fees and commissions	31	38
Fees and commissions from payment transactions	31	35
Fee and commission income	**285**	**293**
Fee and commission expense from trading activities	(2)	(2)
Fee and commission expense	**(2)**	**(2)**
Net fee and commission income	**283**	**291**

3.3 Gains and losses from financial operations

CZKm	2018
Gains and (losses) on securities	(6)
– debt securities at FVOCI	–
– amounts reclassified from other comprehensive income on disposal	–
– changes in fair value of securities held for trading	1
– changes in fair value of securities designated at fair value through profit or loss	(7)
Gain/(loss) of financial assets in fair value	(12)
Gain/(loss) from derivative transactions	(7)
Net gains/ (loss) on hedging derivatives	7
Gain/(loss) from foreign exchange operations	(4)
Total	**(22)**

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

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 2 million in 2018 (2017: CZK 3 million).

3.4 Administrative expenses

CZKm	2018	2017
Wages, salaries and bonuses	(190)	(184)
Social security costs	(57)	(54)
of which: state pension scheme contributions	(41)	(37)
Total personnel expenses	**(247)**	**(238)**
General administrative expenses	(108)	(107)
Total administrative expenses	**(355)**	**(345)**

Wages, salaries and key management compensations:

CZKm	2018	2017
Wages and salaries of the Bank's employees	(127)	(120)
Key management personnel compensation	(46)	(48)
– wages and salaries of the Bank's management	(31)	(29)
– compensations to Board of Directors members	(12)	(16)
– compensations to Supervisory Board members	(2)	(2)
– compensation to Audit Committee members	(1)	(1)
Other employees' expenses	(8)	(9)
Social fund expenditures	(9)	(7)
Total wages, salaries and bonuses	**(190)**	**(184)**

Staff Analysis

	2018	2017
Number of members of the Board of Directors	3	3
Number of members of the Supervisory Board	7	8
Number of members of the Audit Committee	3	3
Average number of the Bank's management	17	17
Average number of Bank's employees (excl. above listed)	194	194

Other administrative expenses comprise:

CZKm	2018	2017
General administrative expenses	(70)	(69)
Rental charges	(6)	(6)
Audit, legal, tax and other professional services	(12)	(7)
Depreciation and amortization	(20)	(25)
Total other administrative expenses	**(108)**	**(107)**

3.5 Increase in loan impairment and write-offs

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

CZKm	31 December 2018	31 December 2017
Loans and advances		
Net additions/release	(39)	(263)
Use	191	176
Write-offs	(263)	(182)
Debt securities		
Net additions/release AC	9	–
Net additions/release FVOCI	30	–
Other assets		
Net additions/release	(1)	(1)
Increase in loan impairment and write-offs	**(73)**	**(270)**

CZKm	31 December 2018	31 December 2017
Loss allowances		
Cash and balances with central banks (Note 3.8)	–	–
Loans and advances to banks (Note 3.9)	–	–
Financial assets at amortized cost		
– loans and advances to customers (Note 3.11)	1,748	1,951
– debt securities (Note 3.13)	2	–
Other assets (Note 3.14)	11	9
Total allowances	**1,761**	**1,960**

Reconciliations from the opening to the closing balance of loss allowances

The change of the allowances can be analysed as follows:

CZKm	Receivables from customers	Other receivables	Securities	Total
Balance at 1 January 2017	**1,864**	**8**	**–**	**1,872**
Net additions/release	263	1	–	264
Use	(176)	–	–	(176)
Balance at 31 December 2017	**1,951**	**9**	**–**	**1,960**
Implementation of IFRS 9	(51)	1	11	(39)
Balance at 1 January 2018	**1,900**	**10**	**11**	**1,921**

Financial assets at amortized cost – loans and advances to customers

31 December 2018 CZKm	12-month ECL CZKm	Lifetime ECL not credit-impaired (Stage 2)	Lifetime ECL credit-impaired (Stage 3)	Total
Balance at 1 January 2018	**72**	**95**	**1,733**	**1,900**
Transfer to 12-month ECL (Stage 1)	23	(13)	(10)	–
Transfer to lifetime ECL not credit-impaired (Stage 2)	(1)	7	(6)	–
Transfer to lifetime ECL credit-impaired (Stage 3)	–	(1)	1	–
New financial assets originated or purchased Financial assets that have been derecognised	15	–	–	15
Write-offs	(4)	(4)	(9)	(17)
Recoveries of amounts previously written off	–	–	(266)	(266)
Revaluation and changes in models/risk parameters	–	–	3	3
Foreign exchange and other movements	(55)	(18)	187	114
New financial assets originated or purchased	–	–	(1)	(1)
Balance at 31 December 2018	**50**	**66**	**1,632**	**1,748**

Financial assets at amortized cost – debt securities

31 December 2018 CZKm	12-month ECL (Stage 1)	Lifetime ECL not credit-impaired (Stage 2)	Lifetime ECL credit-impaired (Stage 3)	Total
Balance at 1 January 2018	**11**	**–**	**–**	**11**
New financial assets originated or purchased	1	–	–	1
Revaluation and changes in models/risk parameters	(10)	–	–	(10)
Balance at 31 December 2018	**2**	**–**	**–**	**2**

Other financial assets

31 December 2018 CZKm	12-month ECL (Stage 1)	Lifetime ECL not credit-impaired (Stage 2)	Lifetime ECL credit-impaired (Stage 3)	Total
Balance at 1 January 2018	**1**	**–**	**9**	**10**
Transfer to 12-month ECL (Stage 1)	(1)	–	1	–
New financial assets originated or purchased	49	–	–	49
Financial assets that have been derecognised	(49)	–	–	(49)
Write-offs	–	–	(1)	(1)
Revaluation and changes in models/risk parameters	–	–	2	2
Balance at 31 December 2018	**–**	**–**	**11**	**11**

Loss allowances – 31 December 2018

31 December 2018 CZKm Rating	Impairment stage of IFRS 9	Receivables from customers	Securities	Other financial assets	Total
Loan rating 1 – 6 (incl. X7)	stage 1	51	2	–	53
Loan rating 7 (incl. X8)	stage 2	65	–	–	65
Loan rating 8 – 10 (incl. X9)	stage 3	1,632	–	11	1,643
Total		**1,748**	**2**	**11**	**1,761**

3.6 Provisions for guarantees and other provisions

The Bank reported the following provisions and loss allowances as at 31 December 2018:

CZKm	31 December 2018	31 December 2017
Provisions		
Provisions for guarantees (Note 3.22)	3,301	3,167
Provisions for loan commitments (Note 3.22)	16	15
Provisions for credit lines	1	–
Other provisions	20	32
Total	**3,338**	**3 ,214**

Overall charge for the guarantees and other provisions impairment can be analysed as follows:

CZKm	31 December 2018	31 December 2017
Guarantees		
Net additions/release	(112)	(40)
Use	1	5
Loan commitments		
Net additions/release	(12)	(14)
Other provisions		
Net additions/release	(9)	(29)
Use	21	28
Interest expense from unwinding discounts	**–**	**47**
Increase in provisions for guarantees and other provisions	**(111)**	**(3)**

The change of the provisions can be analysed as follows:

CZKm	Provisions for guarantees	Provisions for loan commitments	Provisions for off-balance sheet exposures	Other provisions	Total
Balance at 1 January 2017	**3,132**	**1**	**3,133**	**32**	**3,165**
Net additions/release	39	14	53	71	124
Use	(5)	–	(5)	(70)	(75)
Balance at December 2017	**3,166**	**15**	**3,181**	**33**	**3,214**
Implementation of IFRS 9	24	(10)	14	–	14
Balance at 1 January 2018	**3,190**	**5**	**3,195**	**33**	**3,228**

Reconciliation of the provisions for guarantees and other provisions:

CZKm	2018	2017
Balance at 1 January	**3,214**	**3,165**
Increase/(decrease) in provisions for guarantees and loan commitments	137	1
Increase/(decrease) in other provisions	(13)	1
Interest expense from unwinding discounts (Note 3.1)	–	47
Balance at 31 December	**3,338**	**3,214**

Reconciliation of opening and closing balances of provisions

Provided guarantees

31 December 2018 CZKm	12-month ECL (Stage 1)	Lifetime ECL not credit-impaired (Stage 2)	Lifetime ECL credit-impaired (Stage 3)	Total
Balance at 1 January 2018	**2,505**	**270**	**415**	**3,190**
Transfer to 12-month ECL (Stage 1)	(130)	59	71	–
Transfer to lifetime ECL not credit-impaired (Stage 2)	6	(18)	12	–
Transfer to lifetime ECL credit-impaired (Stage 3)	3	41	(44)	–
New financial assets originated or purchased	692	–	–	692
Financial assets that have been derecognised				
Write-offs	(428)	(10)	(41)	(479)
Revaluation and changes in models/risk parameters	0	0	(1)	(1)
Foreign exchange and other movements	120	(129)	(92)	(101)
Balance at 31 December 2018	**2,768**	**213**	**320**	**3,301**

Loan commitments and credit lines

31 December 2018 Balance at 1 January 2018	12-month ECL (Stage 1)	Lifetime ECL not credit-impaired (Stage 2)	Lifetime ECL credit-impaired (Stage 3)	Total
Balance at 1 January 2018	**5**	**–**	**–**	**5**
New financial assets originated or purchased	15	–	–	15
Financial assets that have been derecognised	(4)	–	–	(4)
Revaluation and changes in models/risk parameters	1	–	–	1
Balance at 31 December 2018	**17**	**–**	**–**	**17**

In 2018, it consisted of:

- a provision for the annual contribution to the Resolution Fund of CZK 22 million (as at 31 December 2017: CZK 30 million. Together with the payment to the Resolution Fund a provision of CZK 21 million (31 December 2017: CZK 28 million) was used, remaining part of the created reserve in amount MCZK 11 was released. The rest (CZK 20 million) will be used as a contribution for 2019 based on the actual amount stated by the CNB.

3.7 Income taxes

CZKm	2018	2017
Profit or loss before income tax	**79**	**(34)**
Theoretical tax calculated at a statutory income tax rate 2018: 19% (2017: 19%)	15	(6)
Non-taxable income from securities-permanent difference	–	(1)
Effect of non-recognized contingent deferred tax asset	43	109
Share of profit of equity-accounted investees	–	(2)
Other items	2	(59)
Income tax expense as reported in income statement	**60**	**41**
– current	57	41
– deferred	3	–
Income tax paid during the year	39	48
Current income tax assets at 31 December	–	7
Current income tax liabilities at 31 December	18	–
Effective tax rate	**76%**	**(121)%**

Deferred taxation

The recognized deferred tax can be analysed as follows:

CZKm	31 December 2018	31 December 2017
Other provisions	11	12
Deferred tax recognized in other comprehensive income for revaluation of available for sale securities	(17)	(72)
Total deferred tax	**(6)**	**(60)**

CZKm	31 December 2018	31 December 2017
Deferred tax reported in the statement of financial position – to be recovered after more than 12 months	–	–
– to be recovered within 12 months	11	12
Deferred tax recognized in other comprehensive income for revaluation of available for sale securities – to be recovered within 12 months	(17)	(72)
Total deferred tax	**(6)**	**(60)**

Potential deferred tax asset of CZK 447 million as at 31 December 2018 (2017: CZK 512 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	2018	2017
Deferred tax balance at 1 January	**(60)**	**(129)**
Movement through income statement	(2)	–
Movement in deferred tax recognized in other comprehensive income for revaluation of available for sale securities	56	69
Deferred tax balance at 31 December	**(6)**	**(60)**

The deferred tax is calculated at the statutory income tax rate of 19% (31 December 2017: 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 2018	31 December 2017
Obligatory minimum reserves	68	77
Cash in hand	3	7
Loans provided to CNB	600	180
Net carrying amount	**671**	**264**

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

Balances with central banks – loss allowance

CZKm		31 December 2017
Gross amount	668	257
Loss allowances	–	–
Total	**668**	**257**

As at 31 December 2018, balances with central banks are neither credit-impaired nor has a significant increase in credit risk been identified with them. As at 31 December 2018, loss allowances were calculated based on a 12-month expected credit loss (ECL).

3.9 Loans and advances banks

CZKm	31 December 2018	31 December 2017
Current accounts with other banks	5	4
Included in cash and cash equivalents (Note 3.21.)	5	4
Term deposits	3	–
Other amounts due from banks	54	78
Net carrying amount	**62**	**82**

Classification of receivables from banks by measurement categories

All receivables from banks as at 31 December 2018 are measured at amortised cost under IFRS 9.

Receivables from banks by type – loss allowances

CZKm	31 December 2018	31 December 2017
Gross amount	62	82
Loss allowances	–	–
Total	**62**	**82**

As at 31 December 2018, balances with banks are neither credit-impaired nor has a significant increase in credit risk been identified with them. As at 31 December 2018, loss allowances were calculated based on a 12-month expected credit loss (ECL).

Receivables from banks – classification and loss allowance – 31 December 2017

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 2018	31 December 2017
Government bonds – domestic	–	–
Securities held for trading	**–**	**–**
Government bonds – domestic	–	–
Government bonds – foreign	168	173
Bonds issued by Czech financial institutions	–	–
Securities designated at fair value through profit or loss	168	173
Total securities at fair value through profit or loss	**168**	**173**

3.11 Loans and advances to customers

Receivables from customers by measurement categories

CZKm	31 December 2018	31 December 2017
Receivables from customers measured at amortised cost	4,080	4,378
Receivables from customers measured at FVTPL	31	0
Net receivables from customers	**4,111**	**4,378**

Loans and advances

CZKm	31 December 2018	31 December 2017
Loans to private legal entities and individuals	3,925	3,399
Loans to the Ministry of Finance and other government entities	1,628	2,541
Loans to municipalities	306	389
Gross amounts due from customers	**5,859**	**6,329**
Provisions for loans to customers (Note 3.5)	(1,748)	(1,951)
Net amounts due from customers	**4,111**	**4,378**

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 2018		31 December 2017	
	Assets CZKm	Liabilities CZKm	Assets CZKm	Liabilities CZKm
CZK – principal	526	526	1,037	1,037
CZK – accrued interest	1	1	1	1
EUR – principal	1,089	1,089	1,486	1,486
EUR – accrued interest	12	12	17	17
Total	**1,628**	**1,628**	**2,541**	**2,541**

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 FVOCI

Financial assets at fair value through other comprehensive income

Equity instruments

CZKm	31 December 2018	31 December 2017
Equity instruments	**33**	**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.

Debt securities at FVOCI

31 December 2018 CZKm	Stage 1 12-month ECL	Stage 2 Lifetime ECL not credit-impaired	Stage 3 Lifetime ECL credit-impaired	Total
Net carrying amount	**12,731**	**0**	**0**	**12,731**

Debt securities at FVOCI are recognised at fair value in the balance sheet. The carrying amount is not reduced by a loss allowance of CZK 4 689 thousand. The loss allowance is booked in the revaluation gains (losses) in equity.

CZKm	31 December 2018	31 December 2017
Fixed income debt securities	3 832	3,769
Variable yield debt securities	8 899	9,927
Total debt securities available for sale	**12 731**	**13,696**

All FVOCI securities as at 31 December 2018 and 2017 were publicly traded on stock exchanges. They are denominated in various currencies and the currency risk is hedged (see Note 4.3).

FVOCI securities of CZK 0 million (2017: 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 the borrower also has an obligation to return it.

Debt securities at (AFS securities) have been issued by the following issuers:

CZKm	31 December 2018	31 December 2017
– Czech state institutions	10,754	10,822
– Czech local government institutions	458	478
– Czech financial institutions	132	826
– Other Czech entities	128	181
– Foreign financial institutions	1,079	1,176
– Other foreign entities	180	213
Total	**12,731**	**13,696**

3.13 Financial assets at amortized cost

Securities at amortized cost have been issued by the following issuers:

31 December 2018 CZKm	Stage 1 12-month ECL	Stage 2 Lifetime ECL not credit-impaired	Stage 3 Lifetime ECL credit-impaired	Total
Debt securities	6,134	–	–	6,134
Gross amount	**6,134**	**–**	**–**	**6,134**
Loss allowances	(2)	–	–	(2)
Net carrying amount	**6,132**	**–**	**–**	**6,132**

CZKm	31 December 2018	31 December 2017
Czech state institutions	6,132	4,608
Total securities at AC	**6,132**	**4,608**

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

Securities at AC of CZK 0 million (2017: 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 2018	31 December 2017
Financial assets		
Accrued income	25	30
Non-financial assets		
Prepaid expenses	4	12
Other	30	14
Total other assets, gross	**59**	**56**
Impairment provisions	(11)	(9)
Total other assets, net	**48**	**47**

3.15 Investment 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 2018 and 2017.

Shareholders' structure	31 December 2018	31 December 2017
ČMZRB	49%	49%
Ministry of Finance	49%	49%
Association of Czech Municipalities	**2%**	**2%**

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 2018 and for the year then ended	24	12	24	(1)	–
At 31 December 2017 and for the year then ended	24	12	24	4	2

In 2017 MUFIS a.s. paid out a dividend to the Bank in the amount of CZK 98 million. In 2018, the company's business is limited.

3.16 Property, plant and equipment

CZKm	Land	Buildings	Equipment and fittings	Total
At 1 January 2017				
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**
Year ended 31 December 2018				
Opening net book value	10	98	10	118
Additions	–	11	16	27
Disposals	–	–	(13)	(13)
Depreciation charge	–	(8)	(4)	(12)
Closing net book value	**10**	**101**	**9**	**120**
At 31 December 2018				
Acquisition cost	10	324	81	415
Accumulated depreciation	–	(223)	(72)	(295)
Net book value	**10**	**101**	**9**	**120**

3.17 Deposits from BANKS

CZKm	31 December 2017	31 December 2017
Due to other banks	2,318	3,527
Repo operations with other banks	–	–
Received term deposits from other banks	–	171
Amounts due to banks	**2,318**	**3,698**

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 2,318 million at 31 December 2018 (31 December 2017: CZK 3,527 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 2018	31 December 2017
Current accounts	1,198	1,596
Term deposits	3,459	1,758
Loans received	45	49
Guarantee deposits	6,299	5,597
Other payables to clients	2,125	1,748
Total	**13,126**	**10,748**

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

CZKm	31 December 2018	31 December 2017
Due to government institution	8,597	8,253
Due to other financial institutions	4,241	2,128
Due to non-financial entities	46	77
Due to households (including SVJ)	241	290
Total	**13,126**	**10,747**

The ‘Amounts due to government 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 2018	31 December 2017
Funding from the providers of the individual support * programs not yet returned	7,061	6,251
Funds deposited by the program partners to cover risks attached to providing the financial guarantees **	2,212	1,990

* of which: programme Expansion loans and Energy savings CZK 1,866 million (as at 31 December 2017: CZK 2,554 million), programme Loans ENERG CZK 130 million (as at 31 December 2017: CZK 130 million), guarantees Expansion CZK 1, 000 million (as at 31 December 2017: CZK 0).

** Risk coverage funds for programs Panel and New Panel in the amount of CZK 969 million (2017: CZK 969 million) are booked in off balance.

3.19 Other liabilities

CZKm	31 December 2018	31 December 2017
Payable to employees	22	20
Deferred income	219	311
– financial guarantees premium deferred income	205	294
– other deferred income	14	17
Accrued expenses (financial liability)	37	41
Amount payable to Ministry for Regional Development in respect to intermediation of the support program (financial liability)	97	160
Other	20	23
Total accruals and other liabilities	**395**	**555**

3.20 Equity and profit allocation

Share capital

		31 December 2018		31 December 2017	
	Nominal value of 1 share (CZK)	Number of shares (pcs.)	Value of shares (CZKm)	Number of shares (pcs.)	Value of shares (CZKm)
Share capital	**239 500**	**10 988**	**2,632**	**10 988**	**2,632**

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 2018 and 2017 can by analysed as follows:

Shareholder	2018 %	2017 %
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	2018 %	2017 %
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 2018 is proposed to be allocated and net profit for 2017 of the Bank was allocated as follows:

CZKm	2018	2017
Allocated to retained earnings	19	(75)
Net profit or loss per statutory financial statements	**19**	**(75)**

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 2018	31 December 2017
Cash and balances with central banks (Note 3.8.)	671	264
Loans and advances to banks (Note 3.9.)	5	4
Total	**676**	**268**

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 2018	31 December 2017
Total issued financial guarantees	19,863	18,622
Loan commitments issued to clients	691	213
Provided credit lines	500	200
Total financial guarantees and loan commitments	**21,054**	**19,035**

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 2018 and 31 December 2017.

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 2018	31 December 2017
Assets	**18,619**	**18,622**
Czech state	18,525	17,983
Associates	1	1
Key management	–	–
Other related parties	93	638
Liabilities	**9,451**	**8,691**
Czech state	8,338	7,497
Associates	24	24
Key management	14	10
Other related parties	1,075	1,160
Revenues	**517**	**485**
Czech state	453	414
Associates	–	–
Key management	–	–
Other related parties	64	71
Expenses	**82**	**25**
Czech state	56	4
Associates	–	–
Key management	16	19
Other related parties	10	2
Collaterals provided under repo transactions and other off-balance sheet assets in the normal course of business	**300**	**–**
Czech state	–	–
Other related parties	300	–
Collaterals received under reverse repo transactions and other off-balance sheet liabilities in the normal course of business	**1,785**	**1,666**
Czech state	816	692
Other related parties	969	974

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 20 million (2017: 37 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 2018 and 2017.

	31 December 2018	31 December 2017
Assets		
Amounts due from banks	0.77%	0.08%
Loans to customers	3.67%	3.32%
Securities FVOCI (AFS)	2.07%	1.46%
Securities at AC (HTM)	3.01%	3.57%
Liabilities		
Amounts due to banks *	–0.28%	–0.16%
Amounts due to customers	0.87%	0.08%
Repo operations with the Ministry of Finance	1.08%	0.14%

* 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 the borrower

The credit rating of small and medium-sized businesses, municipalities, water management enterprises, housing associations and associations of owners of housing units, and non-profit organisations is undertaken in accordance with the Bank's internal regulations and involves assessing the borrower's credit worthiness based on an analysis of economic and other aspects. The assessment of other than economic aspects involves analysing external and internal factors that impact the client's activities and operations. The economic assessment is based on the financial analysis of economic indicators and additional information. Credit worthiness is evaluated in relation to each transaction that carries an element of credit risk during the initial assessment; credit risk exposure is periodically assessed over the whole life of the loan, usually in regular quarterly intervals. As part of the regular credit risk assessment, the Bank primarily focuses on information about the payment moral acquired from the Central Register of Loans and further on information following from an analysis and financial analysis of the financial statements regularly sent by the clients to document their financial position.

In terms of assessing the credit rating of a borrower, the Bank uses its internally developed rating tool which is based on the principle of a synthesis of both financial and non-financial information about the client. The Bank regularly updates its rating tool by the relevant risk-free rates and margins depending on the client's principal activities and other parameters. The Bank has documented the rating tool and its principles. The tool serves as an aid for the analysts' decisions.

Credit risk is expressed by assigning a relevant risk category to the borrower. Credit risk exposure involved in a specific transaction is controlled by determining contractual conditions and obtaining a collateral as a security of the transaction.

The Bank identifies the risk level of individual clients from the small and medium-sized business segment based on an analysis of the client's financial position and the assessment of other than economic aspects (e.g. experience of the Company's management, its qualifications, market position). The Bank generally classifies its clients into ten basic risk categories under the internal rating allocated to individual clients.

For trades concluded on financial markets and for security issuers, the assessment of the client's credit worthiness is based on the rating by internationally renowned rating agencies and on the assessment of economic as well as other than economic aspects. The renowned agencies include Standard and Poor's, Moody's and Fitch Ratings. The creditworthiness of the counterparties and issuers is regularly re-assessed over the duration of the business credit relationship. The periodicity of reassessing depends on the risk category of the counterparties and issuers.

Measuring the credit risk of the portfolio

The Bank analyses the loss experience in respect of the products in individual years and identifies the rate of incurred losses and rate of expected credit losses with regards to the portfolios concluded in individual years. The Bank monitors the loss experience of its guarantee and credit portfolios according to individual product classes and annual tranches while using its own estimates of probability of default (PD) and loss given default (LGD). The results of the analyses are regularly submitted to the Bank's management as underlying information for making decisions on credit risk. They are further used to check the correctness of the set-up of the system of loss allowances and provisions established by the Bank.

The Bank primarily analyses the following segments of its products: infrastructure and municipality loans, loans for small and medium-sized businesses, and individual guarantees for small and medium-sized businesses.

Expected credit losses – effective from 1 January 2018

Inputs, assumptions and techniques used for estimating impairment

Credit risk rating grades are a primary input into the determination of the term structure of PD for credit exposures in relation to time. The Bank collects performance and default information about its credit and guarantee exposures. The Bank employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

A significant increase in credit risk is objectively determined mainly based on a change in the client's internal rating.

In addition to internal rating, a significant increase in credit risk can be identified using additional default indicators:

Information from the market:

- actual or expected significant negative changes in the regulatory, economic or technological environment of the borrower which result in a significant change in the borrower's ability to meet its outstanding liabilities;
- significant negative information from the market;
- the industry is facing structural competitive challenges;
- the industry is facing significant challenges connected with environmental protection, public health, etc.;
- a significant change in the legal regulation of the industry;
- entry of a new strong competitor.

Economic environment/industry

- the industry is facing structural competitive challenges;
- the industry is facing significant challenges connected with environmental protection, public health, etc.;
- a significant change in the legal regulation of the industry;
- entry of a new strong competitor.

Transactional behaviour

- material fines imposed by the tax authority or another authority or investigation due to tax evasion or unlawful minimising of similar levies,
- breach, interruption or suspension of business activities,
- new significant lawsuits.

Security quality and control

- significant changes in the value of the collateral securing the relevant liability,
- a negative change in the condition of the security and enforceability of the security, e.g. a significant insurance event incurred in connection with the key security of the loan – an error in the legal documentation which has impact on the enforceability – lapse of insurance – inability to exercise control over (flows of) assets – untrustworthy valuation etc.

The Bank determines a significant increase in credit risk by reflecting and assessing reasonable and supportable information and factors that are available without undue cost or effort and provide information about the future outlook.

Measurement of expected credit losses

The key inputs into the measurement of ECL are the term structure of the following variables/parameters:

- probability of default (PD)
- loss given by default (LGD)
- exposure at default (EAD).

These parameters are generally derived from internally developed statistical models and historical data that must be adjusted to reflect forward-looking information (FLI).

PD estimates are estimates at a certain date that are calculated based on statistical rating models and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on internally compiled data comprising both quantitative and qualitative factors. Where available, market data may also be used to derive the PD for large corporate counterparties. If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the collateral, seniority of the claim, counterparty industry and recovery costs.

They are calculated on a discounted cash flow basis using the effective interest rate (EIR) as the discounting factor, except for the exposures in the SMEs segment, where EIR is 0. The reason for this approach is the situation in the market where the Bank provides preferential guarantees and loans for the clients at a zero interest rate which corresponds to the standard conditions in the market of development and guarantee institutions.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current exposure allowed under the contract concluded with the counterparty including scheduled and early repayments.

The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD includes the amount drawn, as well as potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For some financial assets, EAD is determined by modelling the range of possible exposure outcomes at various points in time using scenario and statistical techniques.

Additions to loss allowances to receivables, additions to provisions for off-balance sheet exposures and classification of receivables – effective until 31 December 2017

The Bank has established loss allowances and provisions higher than required as the minimum limit in Decree No. 163/2014 Coll., stipulating the prudential rules for banks, credit unions and investment firms, as amended, due to its high credit exposure in the sector of small and medium-sized businesses with significantly above-average credit risk rate for which the Bank's programme support of small and medium-sized businesses is intended. The necessity of higher additions to provisions and loss allowances is justified by the Bank's past experience and corresponds with the historically identified loss rate.

The loss allowances were established on an individual and portfolio basis. On an individual basis, the loss allowances were established to those loans in respect of which a loss event defined as a default under the criteria stipulated in Regulation (EU) No 575/2013 of the European Parliament and of the Council has been identified. On a collective basis, loss allowances were established to those loans in respect of which no loss event has been identified but the Bank was able to estimate the realised loss from the portfolio of receivables, which has yet not been detected on an individual basis, based on historical experience.

The Bank has established provisions for the off-balance sheet receivables of the individual clients on the portfolio basis as well, applying the same method as for the loss allowances to credit receivables. The loss rate has been monitored separately for the loan and guarantee portfolios. Since 2004, the Bank has also established provisions for irrevocable loan commitments. The provisions were established according to the relevant risk category of the client, reflecting the realisable security.

Until 31 December 2017, the Bank classified receivables into the following risk categories: standard 1 to 6 (CNB 1), watch 7 (CNB 2), substandard 8 (CNB 3), doubtful 9 (CNB 4), and loss 10 (CNB 5). For clients involved in guarantee and loan programmes, the Bank has established a more detailed division within the category "doubtful" to sub-categories 9 and X9. As for the guarantee programmes, the X9 category includes those clients whose receivables are considered doubtful in compliance with the relevant definition but in respect of which the Bank has not had to pay any performance yet and has not been called upon to provide any performance, the client is not involved in any bankruptcy proceedings and is not in default on any payments. As for the loan programmes, the X9 category includes clients whose receivables are considered doubtful in compliance with the relevant definition but have been overdue only 180 days or less.

Securing loan and guarantee receivables

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

The recoverable amount of the collateral reflects both the cost of realising the collateral and the time value of money. If the borrower's receivable is past due by more than 360 days, the Bank does not allocate any value to the collateral. The Bank does not use services of external agencies to assess the creditworthiness of the individual receivables.

Recovery of receivables 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 in accordance with generally applicable legal regulations. To expedite the recovery process, the Bank employs an arbitration clause in respect of loan and guarantee agreements and enforceable notarial and distrained deeds.

Risk concentration

Significant risk concentration is defined by the Bank as a situation where excessive concentration of exposures against mutually related entities or groups or against entities from the same industry, geographical area or business activity would have a significant impact on the Bank's performance and stability under negative developments.

The risk concentration in the Bank is concentrated primarily in the field of preferential guarantees for loans to small and medium-sized businesses and for loans issued on repairs of apartment houses, preferential loans issued by the Bank to small and medium-sized businesses and loans to entrepreneurs and municipalities for water management projects. A majority of these loans and guarantees is provided in cooperation with the government. Given the fact that the state participates in covering a portion of these risks in respect of some loans and guarantees, the risk is diversified among several entities. The Bank manages its concentration risk in relation to the credit exposure rules, using a system of limits for credit risk management. To identify the concentration of credit risk, the Bank mainly uses methods and

procedures that are based on analysis of data which are stored in the Bank's internal business and accounting system. The Bank does not use any hedging derivatives to eliminate these risks. The risks are periodically monitored.

Financial market instruments

In accordance with its internal policies, the Bank defines financial instruments in which it can invest and through which it can manage currency and interest rate risks. These financial instruments primarily include deposits, bonds (mortgage bonds, bonds denominated in Czech koruna (CZK), foreign-currency bonds, and Eurobonds), bills of exchange, and derivatives (foreign-exchange transactions – FX, cross-currency swaps – CCS, and interest rate swaps – IRS). The credit rating of the counterparties and issuers is based on assessment of their creditworthiness which follows from the rating allocated by internationally renowned rating agencies and assessment of economic and non-economic aspects. The creditworthiness of the counterparties and issuers is regularly re-assessed over the entire duration of the credit relationship.

4.1.2 Credit risk – quantitative disclosures

aa) Quality of amounts due from customers

Receivables from customers at amortised cost by credit risk rating stages

31 December 2018 CZKm	Stage 1 12-month ECL	Stage 2 Lifetime ECL not credit-impaired	Stage 3 Lifetime ECL not credit-impaired	Total
Rating				
Loan rating 1 – 6 (incl. X7)	3,458	–	–	3,458
Loan rating 7 (incl. X8)	–	150	–	150
Loan rating 8 – 10 (incl. X9)	–	–	2,220	2,220
Gross receivables from customers	**3,458**	**150**	**2,220**	**5,828**
Loss allowances	(51)	(65)	(1,632)	1,748
Net receivables from customers	**3,407**	**85**	**588**	**4,080**

Receivables in stage 3 also include receivables from guarantees paid in the amount of CZK 1,776 million.

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

31 December 2017

CZKm	Risk category							
Classes of financial assets	**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**

Analysis of financial assets that are individually determined to be impaired

31 December 2017

CZKm	Risk category					
Classes of financial assets	**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**

Analysis by regulatory rating

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

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

Analysis of provisions by risk category – 31 December 2018

31 December 2018 CZKm Rating	Impairment stage of IFRS	Receivables from customers	Securities	Other financial assets	Total
Loan rating 1 – 6 (incl. X7)	stage 1	51	2	–	53
Loan rating 7 (incl. X8)	stage 2	65	–	–	65
Loan rating 8 – 10 (incl. X9)	stage 3	1,632	–	11	1,643
Total		**1,748**	**2**	**11**	**1,761**

Analysis of provisions by risk category – 31 December 2017

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

Analysis by collateral

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

CZKm	31 December 2018	31 December 2017
Bank guarantees and collateral by reliable guarantors	832	719
Cash collateral	3	5
Real estate collateral	200	544
Other loan collateral	79	54
Uncollateralized	4,745	5,007
Total	**5,859**	**6,329**
Impairment provision for loans to customers (Note 3.5)	(1,748)	(1,951)
Net amounts due from customers	**4,111**	**4,378**

Renegotiated loans to customers

CZKm	31 December 2018	31 December 2017
Loans to private legal entities and individuals	110	71

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.

ab) Quality of guarantees portfolio

31 December 2018 in CZKm Programs	Risk classification 5	6	X7[1]	7	X8[2]	X9[3]	9	10	No risk category*	Total
Guarantees for small and medium sized enterprises provided until 2006	–	3	33	–	–	12	–	28	–	76
PANEL small portfolio guarantees	–	23	62	–	5	8	–	4	138	240
PANEL individual investment guarantees	–	591	1,262	–	262	185	–	3	–	2,303
Vadium	–	1	17	–	–	–	–	–	–	18
Small portfolio guarantees for businessmen since 2007	–	–	5	–	10	1	–	–	192	208
Small portfolio guarantees without external risk enhancement	27	256	770	1	180	38	2	3	11,989	13,266
Guarantees 2015 funded by Ministry of Industry and Trade		43	98		25	3			1,927	2,096
Individual investment and operating guarantees for small and medium sized enterprises since 2007	–	222	813	–	292	256	–	73	–	1,656
Total	**27**	**1,139**	**3,060**	**1**	**774**	**503**	**2**	**111**	**14,246**	**19,863**

* Portfolio approach

[1] Receivables are not overdue for more than 30 days and there is no call for guarantee payment.
[2] Receivables are not overdue for more than 90 days and there is no call for guarantee payment.
[3] Receivables are not overdue for more than 180 days and there is no call for guarantee payment.

31 December 2017 in CZKm Programs	Risk classification 5	6	7	8	X9[4]	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

ac) Quality of Securities portfolio

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

31 December 2018

CZKm	AA– to AA+	A– to A+	Lower than A	Total
Securities at fair value through profit or loss	–	168	–	168
Equity instruments FVOCI	–	–	33	33
Securities FVOCI	10,459	1,647	625	12,731
Securities at amortized cost	3,849	2,283	–	6,132
Total	**14,308**	**4,098**	**658**	**19,064**

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**

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

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 2018

Assets CZKm	Czech Republic	European Union	Total
Cash and balances with central banks	671	–	671
Amounts due from banks	59	3	62
Securities at fair value through profit or loss	–	168	168
Positive fair values of financial derivative transactions	13	–	13
Loans and advances to customers	4,111	–	4,111
Equity instruments FVOCI	–	33	33
Securities FVOCI	11,472	1,259	12,731
Securities at amortized cost	6,132	–	6,132
Investment in associate	12	–	12
Other financial assets	25	14	39
Total financial assets	**22,495**	**1,477**	**23,972**
Non-financial assets	143	–	143
Total	**22,638**	**1,477**	**24,115**

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
Investment in associate	12	–	12
Other financial assets	30	–	30
Total financial assets	**21,696**	**1,594**	**23,290**
Non-financial assets	157	–	157
Total	**21,853**	**1,594**	**23,447**

c) The Bank's maximum credit risk exposure

31 December 2018

in CZKm	Assets	Total exposure Financial guarantees and loan commitments	Total credit exposure	Collateral held
Cash and balances with central banks	671	–	671	–
Amounts due from banks	62	–	62	–
Securities at fair value through profit or loss	168	–	168	–
Financial derivatives	13	–	13	–
Loans to customers	4,111	–	4,111	1,114
– Loans to private legal entities and individuals	2,196	–	2,196	1,025
– Loans to the Czech government entities	1,626	–	1,626	–
– Loans to municipalities	289	–	289	89
Equity instruments FVOCI	33	–	33	–
Securities FVOCI	12,731	–	12,731	–
Securities at amortized cost	6,132	–	6,132	–
Investment in associate	12	–	12	–
Other financial assets	39	–	39	–
Financial guarantees and loan commitments	–	21,054	–	2,112
Total financial assets	**23,972**	**21,054**	**45,026**	**3,226**
Non-financial assets	143			
Total assets	**24,115**			

31 December 2017

in CZKm	Assets	Total exposure Financial guarantees and loan commitments	Total credit exposure	Collateral held
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	–
Investment in associate	12	–	12	–
Other financial assets	30	–	30	–
Financial guarantees and loan commitments	–	19,035	–	1,990
Total financial assets	**23,290**	**19,035**	**42,325**	**3,312**
Non-financial assets	157			
Total assets	**23,447**			

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).

Quantitative information about the collateral for credit-impaired financial assets (Stage 3)

in CZKm	2018
Less than 50%	16
51 – 70%	4
More than 70%	360
Total	**380**

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 Derivatives

Trading derivatives

	31 December 2018		31 December 2017	
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	785	782	1,063	1,066
Total	**1,285**	**1,282**	**1,563**	**1,566**

	31 December 2018		31 December 2017	
CZKm	Positive fair value	Negative fair value	Positive fair value	Negative fair value
Interest rate swaps	–	11	–	23
Currency swaps	13	24	15	35
Total	**13**	**35**	**15**	**58**

Maturity of trading derivatives as at 31 December 2018

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	–	300	200	–	500
Currency and cross-currency swaps	–	29	568	188	785
Total	**–**	**329**	**768**	**188**	**1 285**

Maturity of trading derivatives as at 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	–	–	500	–	500
Currency and cross-currency swaps	19	84	494	466	1 063
Total	**19**	**84**	**994**	**466**	**1 563**

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 2018 Notional value asset	31 December 2018 Notional value asset	31 December 2017 Notional value asset	31 December 2017 Notional value liability
Cross currency swaps	86	96	111	125
Total	**86**	**96**	**111**	**125**

CZKm	31 December 2017 Positive fair value	31 December 2017 Negative fair value	31 December 2017 Positive fair value	31 December 2017 Negative fair value
Cross currency swaps	–	16	–	25
Total	**–**	**16**	**–**	**25**

Maturity of hedging derivatives as at 31 December 2018

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Celkem
Cross currency swapy	0	0	85 750	0	85 750
Celkem	**0**	**0**	**85 750**	**0**	**85 750**

Maturity of hedging derivatives as at 31 December 2017

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Cross currency swapy	0	0	110 673	0	110 673
Celkem	**0**	**0**	**110 673**	**0**	**110 673**

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, analysed 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 2018

CZKm	CZK	EUR	Other	Total
Cash and balances with central bank	671	–	–	671
Amounts due from banks	59	3	–	62
Securities at fair value through profit or loss	–	168	–	168
Financial derivatives	13	–	–	13
Loans to customers, net	3,011	1,100	–	4,111
Equity instruments FVOCI	–	33	–	33
Securities FVOCI	12,472	259	–	12,731
Securities at amortized cost	6,132	–	–	6,132
Investment in associate	12	–	–	12
Other financial assets	25	14	–	39
Total financial assets	**22,395**	**1,577**	**–**	**23,972**
Non-financial assets	**143**	**–**	**–**	**143**
Total assets	**22,538**	**1,577**	**–**	**24,115**
Amounts due to banks	491	1,827	–	2,318
Amounts due to customers	12,863	263	–	13,126
Financial derivatives	50	–	–	50
Other financial liabilities	134	–	–	134
Total financial liabilities	**13,538**	**2,090**	**–**	**15,628**
Non-financial liabilities and equity	**8,480**	**7**		**8,487**
Total liabilities and equity	**22,018**	**2,097**	**–**	**24,115**
Statement of financial position net	520	(520)	–	–
Off-balance sheet derivatives notional position, net	–	572	–	–
Net position	**520**	**52**	**–**	**–**

31 December 2017

CZKm	CZK	EUR	Other	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
Investment in associate	12	–	–	12
Other financial assets	30	–	–	30
Total financial assets	**21,316**	**1,973**	**1**	**23,290**
Non-financial assets	**157**	**–**	**–**	**157**
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**	**–**

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 2018 or 2017 as EUR was the only significant currency in which the Bank had open position as at that date (for open position amounts see above).

	2018 CZKm	2017 CZKm
Sensitivity to changes in EUR rates		
Expected rate fluctuation, %	10%	10%
Open position	53	56
Effect on profit and loss	(23)	(23)
Effect on equity	26	26

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 2018

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Non-specified	Total
Cash and balances with central bank	668	–	–	–	3	671
Amounts due from banks	62	–	–	–	–	62
Securities at fair value through profit or loss	–	4	164	–	–	168
Financial derivatives	–	–	–	–	13	13
Loans to customers, net	306	690	2,183	386	546	4,111
Equity instruments FVOCI	–	–	–	–	33	33
Securities FVOCI	–	638	8,514	3,579	–	12,731
Securities at amortized cost	–	971	864	4,297	–	6,132
Investment in associate	–	–	–	–	12	12
Other financial assets	–	–	–	–	39	39
Total financial assets	**1,036**	**2,303**	**11,725**	**8,262**	**646**	**23,972**
Non-financial assets	**–**	**–**	**–**	**–**	**143**	**143**
Total	**1,036**	**2,303**	**11,725**	**8,262**	**789**	**24,115**
Amounts due to banks	441	597	1,231	71	(22)	2,318
Amounts due to customers	9,850	–	–	–	3,276	13,126
Financial derivatives	–	–	–	–	50	50
Other financial liabilities	–	–	–	–	134	134
Total financial liabilities	**10,291**	**597**	**1,231**	**71**	**3,438**	**15,628**
Non-financial liabilities and equity	**–**	**–**	**–**	**–**	**8,487**	**8,487**
Total	**10,291**	**597**	**1,231**	**71**	**11,925**	**24,115**
Net interest position	**(9,255)**	**1,706**	**10,494**	**8,191**	**(11,136)**	**–**

31 December 2017

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Non-specified	Total
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
Investment in associate	–	–	–	–	12	12
Other financial assets	–	–	–	–	30	30
Total financial assets	**1,100**	**1,468**	**13,644**	**6,510**	**568**	**23,290**
Non-financial assets	**–**	**–**	**–**	**–**	**157**	**157**
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)**	**–**

Interest rate sensitivity analysis

Statement of financial position items sensitive to interest rates were analysed 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 2018 Sensitivity/Impact	31 December 2017 Sensitivity/Impact	Comment
Assets			
Loans to customers	(101)	(61)	
Loans to banks	(1)	(2)	
Securities at AC (HTM)	–	–	Only fixed interest rates securities in the portfolio
Securities FVOCI (AFS)	(62)	(78)	Impact on equity reserve
Securities FVOCI (AFS)	(149)	(219)	Impact on profit and loss
Financial derivatives	(6)	(47)	
Liabilities			
Due to banks	77	134	
Due to customers	6	2	
Financial derivatives	27	50	

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 2018

	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	669	–	–	–	2	671
Amounts due from banks	9	–	–	–	53	62
Securities at fair value through profit or loss	–	4	164	–	–	168
Financial derivatives	–	12	–	1	–	13
Loans to customers, net	33	1,423	2,372	280	3	4,111
Equity instruments FVOCI	–	–	–	–	33	33
Securities FVOCI	–	638	8,514	3,579	–	12,731
Securities at amortized cost	–	971	864	4,297	–	6,132
Investment in associate	–	–	–	–	12	12
Other financial assets	7	15	–	–	17	39
Total financial assets	**718**	**3,063**	**11,914**	**8,157**	**120**	**23,972**
Non-financial assets	**1**	**2**	**–**	**–**	**140**	**143**
Total	**719**	**3,065**	**11,914**	**8,157**	**260**	**24,115**
Amounts due to banks	281	629	1,372	36	–	2,318
Amounts due to customers	4,668	6,299	42	2,117	–	13,126
Financial derivatives	–	5	43	2	–	50
Other financial liabilities	–	–	–	–	134	134
Total financial liabilities	**4,949**	**6,933**	**1,457**	**2,155**	**134**	**15,628**
Non-financial liabilities and equity	**323**	**1,150**	**1,302**	**783**	**4,929**	**8,487**
Total	**5,272**	**8,083**	**2,759**	**2,938**	**5,063**	**24,115**
Net liquidity exposure	**(4,553)**	**(5,018)**	**9,155**	**5,219**	**(4,803)**	**–**

31 December 2017

	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	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
Investment in associate	–	–	–	–	12	12
Other financial assets	23	–	–	–	7	30
Total financial assets	**1,285**	**1,593**	**13,973**	**6,307**	**132**	**23,290**
Non-financial assets	**6**	**5**	**–**	**–**	**146**	**157**
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)**	**–**

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 2018

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	2,587	683	1,452	–	4,722
Amounts due to customers	5,238	751	7,099	36	13,124

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

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 2018

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	–	(9)	(3)	–	(12)

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)

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.

31 December 2018

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Cross-currency swaps:					
Cash inflows	60	155	604	75	894
Cash outflows	(55)	(178)	(641)	(75)	(949)

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)

4.6 Operational risk

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.

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, operational risk and strategic risk.

4.7 Capital management

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 2018	31 December 2017
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)	775	766
Less: Values adjusting according to requirements for prudent valuation	(1)	(1)
Less: intangible assets	(14)	(15)
Total qualifying Tier 1 capital	**4,542**	**4,532**
Total regulatory capital	**4,542**	**4,532**
Total risk weighted exposure	**20,358**	**21,071**
Capital ratio	**22,31%**	**21,51%**

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 2018 Carrying value	31 December 2018 Fair value	31 December 2017 Carrying value	31 December 2017 Fair value
Financial assets				
Cash and balances with central banks	671	671	264	264
Loan and advances to banks	62	92	82	82
Loans to customers	4,111	3,916	4,378	4,209
Securities at AC (HTM)	6,132	5,963	4,608	4,661
Other financial assets	25	25	30	30
Financial liabilities				
Amounts due to banks	2,318	2,296	3,698	3,633
Amounts due to customers	13,126	12,642	10,748	10,304
Other financial liabilities	134	134	201	201

Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable. Observable inputs reflect market data obtained from independent sources; while 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 the Prague Stock Exchange and other recognised 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 categorised. The amounts are based on the values recognised in the statement of financial position.

31 December 2018	Level 1	Level 2	Level 3
Financial assets at fair value			
Financial assets held for trading			
Derivatives	–	13	–
Financial assets mandatorily recognised in fair value			
Loans and receivables	–	–	31
Financial assets charged against expenses or income			
Debt securities	168	–	–
Loans and receivables	–	–	14
Financial assets at FVOCI			
Equity instruments	–	–	33
Debt securities	12,731	–	
Total assets at fair value	**12,899**	**13**	**78**
Financial liabilities at fair value through profit and loss			
Derivatives held for trading	–	34	–
Hedging derivatives	–	16	–
Total liabilities at fair value	**–**	**50**	**–**

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**	**–**

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.

CZKm	Equity instruments at FVOCI	Loans and receivables mandatorily at FVTPL	Loans and receivables at FVTPL	Total
Balance at 1 January 2018	**32**	**63**	**–**	**95**
Gains or losses for the period recognised in the income statement	–	(12)	(1)	(13)
Gains or losses for the period recognised in equity	1	–	–	1
Purchases	–	–	16	16
Settlements	–	(20)	–	(20)
Balance at 1 December 2018	**33**	**31**	**15**	**79**

6. Subsequent events

No significant events having a material impact on the financial statements of the Bank for the year ended 31 December 2018 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.

Contact addresses

Headquarters

Jeruzalémská 964/4
110 00 Prague 1
tel.: +420 255 721 111
fax: +420 255 721 110
e-mail: podatelna@cmzrb.cz
www.cmzrb.cz

Secretariat of the CEO Division	tel.: +420 255 721 441
Trade Management Division Secretariat	tel.: +420 255 721 381
Financial Division Secretariat	tel.: +420 255 721 276

Branch Offices

- Brno Branch
  Hlinky 47/120, 603 00 Brno
  tel.: +420 538 702 199, fax: +420 538 702 110
  e-mail: infoBM@cmzrb.cz

- Hradec Králové Branch
  Eliščino nábřeží 777/3, 500 03 Hradec Králové
  tel.: +420 498 774 199, fax: +420 498 774 110
  e-mail: infoHK@cmzrb.cz

- Ostrava Branch
  Přívozská 133/4, 701 77 Ostrava
  tel.: +420 597 583 199, fax: +420 597 583 110
  e-mail: infoOV@cmzrb.cz

- Pilsen Branch
  Bezručova 147/8, 303 76 Pilsen
  tel.: +420 378 775 199, fax: +420 378 775 110
  e-mail: infoPM@cmzrb.cz

- Prague Branch
  Jeruzalémská 964/4, 110 00 Prague
  tel.: +420 255 721 199, fax: +420 255 721 584
  e-mail: infoAB@cmzrb.cz

- Regional Office
  Husova 9, 370 01 České Budějovice
  tel./fax: +420 387 318 428, GSM: +420 602 838 537
  e-mail: prochazka@cmzrb.cz

Českomoravská záruční a rozvojová banka, a.s.
www.cmzrb.cz