FHB MORTGAGE BANK PLC

CONSOLIDATED ANNUAL REPORT FOR YEAR 2016
ACCORDING TO IFRS

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Budapest, 4 April, 2017.

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1 OVERVIEW OF FHB GROUP

1.1 FHB MORTGAGE BANK PLC.

FHB Mortgage Bank Public Limited Company ("FHB", "Mortgage Bank" or "the Bank") was established by the Hungarian State on 21 October 1997 as a limited liability company with a share capital of HUF 3 billion.

The Bank provided mortgage banking services through its Head Office and regional representative offices located in Hungary. The Bank also refinances mortgage loans provided by commercial banks to their customers.

The Bank received its license to operate as a specialized financial institution in accordance with the provision of Act CXII of 1996 on Credit Institutions and Financial Enterprises (previous Hpt.) and Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds (Jht.) on 6 March 1998. The Bank commenced operation as of 16 March 1998.

On 31 October 2003 the Hungarian Financial Supervisory Authority (HFSA) granted permission for FHB Mortgage Bank to issue a prospectus to introduce its shares to the Budapest Stock Exchange. The ordinary shares were listed on the Budapest Stock Exchange on 24 November 2003.

FHB Mortgage Bank Co. Plc. at the end of December 2015 increased its share capital with HUF 4,249 billion face value, or HUF 30.5 billion issue value. The capital increase was executed by issuing dematerialized dividend preference shares (Series "B") and dematerialized ordinary shares (Series "C"). The newly issued Series "B" and "C" shares will not be listed over.

The shareholder structure of the Company has changed significantly in the last quarter of 2016. On 14 October 2016 A64 Vagyonkezelő Ltd. sold its shares in the Company over the counter to B3 Takarék and Fókusz Takarék, then on 9 December 2016 Bank of Hungarian Savings Cooperatives Co. Ltd. (Takarékbank) bought the block of shares of VCP Finanz Holding Ltd. As a result the Takarékbank and the cooperative credit institutions obtained more than 68% of the shares of the Company by the end of the year.

On 31 December 2016 FHB Mortgage Bank Plc. had series "A", "B" and "C" shares. Majority (78.2%) of FHB shares is owned by domestic institutional investors.

FHB Group's shareholder structure as of 31 December 2016:

Description of owner	Total equity					
	At the beginning of actual year			End of actual period		
	%	%voting	Qty	%	%voting	Qty
Series "A" shares listed on BSE						
Domestic institution/company	38.64%	44.55%	41,911,917	39.04%	45.01%	42,345,991
Foreign institution/company	10.73%	12.38%	11,642,388	10.69%	12.33%	11,597,658
Domestic individual	6.15%	7.09%	6,669,193	5.93%	6.84%	6,435,206
Foreign individual	0.02%	0.02%	16,326	0.02%	0.02%	22,330
Employees, senior officers	0.07%	0.08%	77,808	0.08%	0.09%	87,963
Treasury shares	0.23%	0.00%	253,601	0.23%	0.00%	253,601
Government held owner	4.45%	5.14%	4,832,225	4.45%	5.14%	4,832,225
Other	0.55%	0.63%	596,552	0.40%	0.46%	425,036
Share serie sub-total	*60.84%*	*69.89%*	*66,000,010*	*60.84%*	*69.89%*	*66,000,010*
Series "B" shares non-listed on BSE						
Domestic institution/company	13.05%	0.00%	14,163,430	13.05%	0.00%	14,163,430
Share serie sub-total	*13.05%*	*0.00%*	*14,163,430*	*13.05%*	*0.00%*	*14,163,430*
Series "C" shares non-listed on BSE						
Domestic institution/company	26.11%	30.11%	2,832,686	26.11%	30.11%	2,832,686
Share serie sub-total	*26.11%*	*30.11%*	*2,832,686*	*26.11%*	*30.11%*	*2,832,686*
TOTAL	**100.00%**	**100.00%**	**82,996,126**	**100.00%**	**100.00%**	**82,996,126**

The Board of Directors of the Bank accepted a strategic plan in February 2006 focusing on the expansion of the banking activity and branch network as a midterm target. In the framework of this, the Bank set up several new subsidiaries, including FHB Commercial Bank Ltd. widening significantly the range of provided services. FHB Mortgage Bank is the parent company of the Group. (The Bank and its subsidiaries are jointly referred to as the Group or Banking Group.)

The Strategic Plan for the business years 2013-2015 was adopted by the Board of Directors of FHB Mortgage Bank in 2012. The new strategy was built on the results achieved with the previous plans, the possible advantages from the strategic partnership with Allianz and the commitment of the employees of the Group and identified regarding the development of the Group. FHB would like to become a customer- and service-driven medium bank based on the previously adopted conception of “The bank of the families” providing customer based service supported by an organisational culture where the achievement of the common goals is reached with the strong co-operation of the employees.

In 2013, FHB Mortgage Bank managed several acquisition, there through broadened the banking group and the range of activities.

The Bank signed a contract in July 2013 to buy close to 100% of ordinary shares of the Diófa Alapkezelő Zrt. (Diófa Asset Management Ltd.). The specified contractual conditions required for the effective transfer of the shares were satisfied by the parties on September 2, 2013, so close to 100% of ordinary shares of Diófa Asset Management went to the ownership of FHB Mortgage Bank.

As a result of several months of negotiations, FHB has signed first a letter of intent, and then on 10 July 2013, a purchase agreement with the shareholders of Díjbeszedő Holding Ltd. (DBH), to the business shares of Díjbeszedő Üzemeltetési és Szolgáltatási Kft. (in English: Díjbeszedő Operational and Service Ltd.; hereinafter DÜSZ) that come into being after a demerge from DBH. In course of the demerge DÜSZ own 51% of the shares of Díjbeszedő Faktorház Ltd. (DBF), 75% of the shares of DíjNET Ltd. and 50% of the shares of Díjbeszedő Informatikai Ltd (DBIT).

Related to the transaction of the business shares, FHB and the Magyar Posta (Hungarian Post) entered into a strategic cooperation, and in the scope of that they cooperate in the ownership and control of FHB Invest Befektetési és Ingatlankezelő Kft. (in English: FHB Invest Investment and Real Estate Management Ltd.; hereinafter: FHB Invest; previously DÜSZ), DBH and the jointly controlled companies, furthermore in course of the harmonization of the business activities of FHB Invest Ltd. and the members of the DBH Group.

Based on the Agreement between FHB Group and Magyar Posta, FHB Invest Ltd. acquired 50% of shares of Magyar Posta Befektetési Zrt. (Hungarian Post Investment Services Ltd., hereinafter MPBSZ Ltd.) in December, 2013.

According to the Syndicate Agreement the subsidiaries of the FHB Invest Ltd. (DBF, DíjNET, DBIT and MPBSZ) are joint venture subsidiaries of FHB and Magyar Posta, which means 50% effective impact on these companies independently of the ownership. From the subsidiaries mentioned above the FHB Invest (DÜSZ), DBF and MPBSZ are under consolidated supervision according to the NBH resolution received on 24 January 2014.

At the beginning of 2014 FHB Mortgage Bank Plc. acquired 25% shares in Magyar Takarék Asset Management Ltd. by capital increase, through which FHB Mortgage Bank obtained (during the year, in two steps) 13,76% indirect qualifying holding in Bank of Hungarian Savings Cooperatives Co. Ltd. after the permission of National Bank of Hungary.

Based on the Act CXXXV of 2013 on integration of cooperative financial institutions and modification of certain rules on economic issues (Szhitv), FHB Mortgage Bank Plc. and the under its qualifying holding and prudential supervisory FHB Commercial Bank Ltd. became a member of Integration Organisation of Cooperative Credit Institution (SZHISZ) on September 23, 2015.

From September 24, 2015, the joint and several responsibilities defined in the Section 4 of Article 1 of Szhitv cover also Mortgage Bank and Commercial Bank, according to the decision of the Board of Directors of Takarékbank Ltd.

FHB Mortgage Bank and its significant investments as at 31 December 2016:

Significant investments	Shareholders										
	FHB Mortgage Bank Plc	FHB Bank Ltd.	FHB Real Estate Ltd.	Diófa Asset Manage-ment Ltd.	FHB INVEST Llc.	FHB Leasing Ltd.	Díjbesze-dő IT Llc.	Magyar Takarék Asset Manage-ment Ltd.	Bank of Hungarian Savings Cooperatives Co. Ltd.	DOM-P IT Services Ltd.	Direct and indirect share total
FHB Commercial Bank Ltd.	51.00%	-	-	-	-	-	-	-	7.39%	-	52.02%
FHB Real Estate Ltd.	100.00%	-	-	-	-	-	-	-	-	-	100.00%
Káry-Villa Ltd.	-	-	100.00%	-	-	-	-	-	-	-	100.00%
Diófa Asset Management Ltd.	89.19%	-	-	-	-	-	-	-	-	-	89.19%
Diófa Real Estate Management Llc.	-	-	-	100.00%	-	-	-	-	-	-	89.19%
FHB INVEST Llc.	100.00%	-	-	-	-	-	-	-	-	-	100.00%
FHB Lease Ltd.	-	-	-	-	100.00%	-	-	-	-	-	100.00%
Central European Credit d.d.	-	-	-	-	-	100.00%	-	-	-	-	100.00%
FHB DWH Ltd.	-	-	-	-	-	100.00%	-	-	-	-	100.00%
Díjbeszedő Faktorház Ltd.	-	-	-	-	51.00%	-	-	-	-	-	51.00%
DíjNET Ltd.	-	-	-	-	51.00%	-	-	-	-	-	51.00%
Díjbeszedő IT Llc.	-	-	-	-	50.00%	-	-	-	-	-	50.00%
Magyar Posta Card Centre Ltd.	-	-	-	-	-	-	49.95%	-	-	-	24.98%
Magyar Posta Investment Services Ltd.	-	-	-	-	50.00%	-	-	-	-	-	50.00%
Hungarian Card Service Plc.	-	99.18%	-	-	-	-	0.82%	-	-	-	50.99%
Magyar Takarék Asset Management Ltd.	25.10%	-	-	-	-	-	-	-	-	-	25.10%
Bank of Hungarian Savings Cooperatives Co. Ltd.	1 db C részvény	1 db C részvény	-	-	-	-	-	54.82%	-	-	13.76%
MPT Security Ltd.	-	-	-	-	10.00%	-	-	-	40.00%	-	15.50%
MA-TAK-EL Ltd.	-	-	-	-	40.00%	-	-	40.00%	-	20.00%	53.21%
DOM-P IT Services Ltd.	-	-	-	-	13.91%	-	-	-	13.91%	-	15.83%

As parent company of FHB Group, the Mortgage Bank exercises proprietary supervision over the Group companies.

1.2 FHB COMMERCIAL BANK LTD.

In line with the midterm strategic plan for the years 2006-2010, Board of Directors of FHB Mortgage Bank decided to establish FHB Commercial Bank Ltd. (FHB Commercial Bank or Commercial Bank) in February 2006. FHB Commercial Bank Ltd. was established from HUF 5,996 million equity including HUF 3,996 million capital reserve and HUF 2,000 million registered capital. At the beginning, 90% of the shares of the Bank were owned by FHB Mortgage Bank and 10% by FHB Services Ltd. After receiving its licence, banking operation started on 5 December 2006 in the Central Branch in Budapest. In 2007, the Bank broadened its branch network and gradually took over the distribution of retail and corporate loans from the Mortgage Bank and started funding activity due to continuously developing account and bank card services. In 2008 the Bank launched its SME business line, and then in 2010 its investment services business line.

As a result of the merge of Allianz Bank Ltd. into FHB Commercial Bank as of 1 April 2011, the number of employees, number of branches and financial assets of Commercial Bank boosted significantly; the product portfolio broadened.

The Commercial Bank provides agency services for Mortgage Bank and other group members, according to which Commercial Bank sells FHB Mortgage loans handles credit portfolio and has got credit care and qualified credit management function.

In September 2014, FHB Mortgage Bank Co. Plc. and Magyar Posta Zrt. contracted on the purchase of ordinary shares representing 49% of the share capital of FHB Commercial Bank Ltd. The closing of the transaction – after the National

Bank of Hungary gave the necessary permission to Hungarian Post to get influence – took place on 30 September 2014. Before the purchase of the share package, the General Meeting of FHB Commercial Bank decided on approximately HUF 20 billion capital increase and entitled the FHB Mortgage Bank to takeover the new shares, which was fully implemented by the Mortgage Bank. The capital increase was registered in the company register on 1 October 2014.

In November 2013 the Bank established FHB Card Centre Ltd. (that was renamed to Hungarian Card Service Ltd. in March 2014), the activity of which is linked to card related electronic payment platform services.

The Commercial Bank's total assets in accordance with Hungarian Accounting Standards (HAS) amounted to HUF 463.8 billion as of 31 December 2016, which decreased by 2.1% the previous year figure (HUF 473.8 billion). Gross loan portfolio of Commercial Bank amounted to HUF 229.1 billion according to HAS, representing 8.2% increase since the end of the year 2015. The Bank's deposit portfolio decreased by 9.7% (299.1 billion) over the past year.

At the end of 2016 the Commercial Bank had 41 branches countrywide, that performed all of the retail bank services. On 31 December 2016 Commercial Bank managed more than 211 thousand retail and more than 12 thousand corporate current accounts to which 170 thousand retail and 6.7 thousand corporate cards belonged.

FHB Commercial Bank's balance sheet profit was HUF 6,691 million losses in 2016, its shareholders' equity at year end was HUF 30.6 billion; and capital adequacy ratio (according to HAS) was 13.16% on 31 December 2016, lower than it was (20.00%) a year ago.

1.3 FHB REAL ESTATE LTD.

FHB Real Estate Ltd. was established on 7 February 2006 based with a share capital of 100 million HUF. At the beginning, 95% of the shares of the Bank were owned by FHB Mortgage Bank and 5% by FHB Services Ltd. FHB Real Estate Ltd. received its licence on 8 May 2006 and started its operation on 1 December 2006. Since 2009 FHB Mortgage Bank is the sole owner of the company.

FHB Real Estate Ltd. was established for the purpose of promoting the implementation of the tasks laid down in FHB Mortgage Bank Plc.'s strategy, specifically to undertake real estate collateral valuation, real estate investment, sales and management services, and as a real estate valuation agent for FHB Group. In addition to Group companies, FHB Real Estate Ltd. provides real estate related services to external customers.

In 2016 the profile of the company has been expended with a new line of business. The changes in the regulations of financial intermediation resulted in the formation of the Partnership Department. Due to the coordination of the new department – realising and taking advantage of the changed market demand - the Company performs loan intermediation activity with subcontractors since the end of the year. The goal and main pillar of the activity is improving business relationships with real estate developer companies and raising result.

The Company closed the year 2016 with HUF 7.8 million profits. The Company's registered capital was HUF 70 million and shareholders' equity HUF 214.9 million at the end of the year.

1.4 FHB LÍZING LTD.

The predecessor of FHB Lease Ltd. was established on 15 December 2004. The company started business on 28 August 2005 with an initial capital of HUF 50 million consisting solely of cash contributions. The company is a financial enterprise. Based on the application of the Company, in December 2014, the National Bank of Hungary permitted new activities. Number of the modified licence is H-EN-I-825/2014. According to the NBH license, the Company is authorised to provide financial leasing services without any limitation and to provide cash loans limited to consumer loan products.

The company joined FHB Group in 2009; its sole shareholder is FHB INVEST Ltd. FHB Real Estate Lease Ltd. is 100% owner of the shares of Central European Credit d.d. and FHB DWH Services Ltd.

The Company's name was changed simultaneously to broadening of its business activities as 15 June 2015 to FHB Lízing Private Limited Company.

FHB Lízing Ltd. is 100% owner of the shares of Central European Credit d.d. and FHB DWH Services Ltd. The former one is a financial company registered in Croatia, while FHB DWH Ltd. main activities are data processing and web hosting services.

The main goal of the Company in 2016 was the expansion of new business lines besides clearing portfolios. The volume of leasing and loan disbursements during the year amounted to HUF 5.5 billion which contains HUF 4.2 billion of production assets and truck leasing.

As at 31 December 2016, the loan volume of FHB Lízing Ltd according to HAS. reached HUF 2.6 billion, while volume of leasing portfolio reached HUF 9.4 billion representing 74.1% increase compared to the data of HUF 5.4 billion at the end of 2015.

The company's capital was increased once in 2016, and the capital increase amounted to HUF 210 million.

The Company closed the year 2016 with HUF 64 million losses. Shareholder's equity of the Company according to HAS amounted to HUF 201.1 million as at 31 December 2016; registered capital was HUF 135 million and capital reserves amounted to HUF 3.1 billion.

1.5 DIÓFA ASSET MANAGEMENT LTD.

Diófa Asset Management Ltd. had been established by Évgyűrűk Pension Fund in February 2009. On 8th July 2013, FHB Mortgage Bank signed a contract to buy almost 100% of the ordinary shares of the Diófa Asset Management Ltd. After the change in ownership, Diófa Asset Management is a fully consolidated member of FHB Group and belongs to common supervision since September 2013.

Before joining to FHB Group, Diófa Asset Management was focusing on real estate investments, pension fund wealth management and tailor made solutions for institutional clients. After the acquisition Diófa Asset Management Ltd. still sustains its former focus areas, in addition new retail funds have been launched in the branch network of FHB Banking Group.

In 2016 the volume of retail mutual funds grew to HUF 160.5 billion which mostly contains the constantly fast-growing Hungarian Post Takarék Real Estate Fund. This real estate fund jumped by HUF 46 billion from HUF 81.4 billion to HUF 127.4 billion. The structure optimisation, the fund managers started in 2015, ended in the beginning of 2016.

Due to the low yield environment money market interest rates and bonds with short maturity can't provide a satisfying return for investors, so they restructured their invest from these categories into more appealing real estate funds. As a result the value of security funds declined slightly throughout the year. The fund management has widened its portfolio with more options after realizing the investor's interest for these funds with higher yield potentials. In accordance a new equity fund has been established in January 2016, that is called Takarék FHB Apollo Derivatives Investment Fund, and a new, more wary mix fund called Hungarian Post Takarék Harmony Mixed Investment Fund in sync with the market trends.

Total net value of assets under management increased to HUF 415.7 billion from HUF 393.0 on December 31, 2015.

Asset Management Ltd. closed the year 2016 with HUF 732.0 million profit after tax according to HAS; subscribed capital amounted to HUF 196.2 million and shareholders' equity exceeded HUF 1.0 billion.

1.6 FHB INVEST INVESTMENT AND REAL ESTATE MANAGEMENT LTD

The DÜSZ was established by demerge from Díjbeszedő Holding Ltd. on 30 September 2013. In course of the demerge DÜSZ own 51% of the shares of Díjbeszedő Faktorház Ltd., 75% of the shares of DíjNET Ltd. and 50% of Díjbeszedő Informatikai Ltd. In December 2013, DÜSZ Ltd. acquired 50% share of Magyar Posta Befektetési Zrt (Hungarian Post Investment Services Ltd.), and as a result of that its proportion of ownership in DíjNET Ltd. changed to 51%.

From 2014, DÜSZ Ltd. is the subsidiary of FHB Group dealing with facility management and with real estate rental. The Board of Directors of FHB Mortgage Bank (who exercising ownership rights) decided at 16 December 2014, that the new company name of DÜSZ is FHB INVEST Investment and Real Estate Management Ltd.

At the end of 2015 FHB Invest bought 13.9% shares of DOM-P IT Services Ltd. and 10.0% shares of MPT Security from FHB Mortgage Bank, while acquiring 40.0% of MA-TAK-EL Ltd.

1.7 JOINTLY CONTROLLED AND ASSOCIATED COMPANIES

Díjbeszedő Faktorház Ltd. (DBF) realised HUF 943.4 million profit after tax in 2016 according to HAS. Shareholder's equity of the Company based on HAS amounted to HUF 6.0 billion as of 31 December 2016.

The main activity of DíjNET Ltd. is operation and development of an electronic bill presentment and payment system. In 2016, profit after tax (according to HAS) reached HUF 65.9 million. Subscribed capital amounted to HUF 5 million, while shareholder's equity was HUF 262.6 million at 31 of December 2016.

Díjbeszedő IT Ltd. (DBIT), which provides services related to the IT activities of companies belonging to the Díjbeszedő Group, realised HUF 26.1 million profit after tax in full year 2016. Subscribed capital amounted to HUF 672 million, while shareholder's equity amounted to HUF 706.4 million at the end of December 2016.

By the end of December 2016, Magyar Posta Investment Services Ltd. opened nearly 56 thousand securities and long-term investment accounts; the market value of securities portfolio managed on accounts was HUF 178.0 billion at the end of 2016, compared to HUF 116.8 billion at the end of December 2015. MPBSZ closed 2016 with HUF 147.4 million loss (according to HAS). The company's shareholder's equity was HUF 358.1 million and total assets amounted to HUF 3.9 billion.

These associated companies owned by FHB Invest Ltd. are jointly managed by FHB and Magyar Posta according to a syndicate agreement.

FHB Mortgage Bank owns 25.1% of shares in Magyar Takarék Asset Management (MATAK) Ltd. The results of MATAK – taking into account the results of Bank of Hungarian Savings Cooperatives Co. Ltd. and its companies falling within the scope of consolidation – contributed by HUF 245 million to the consolidated results of Banking Group in 2016.

2 MACROECONOMIC AND MARKET ENVIRONMENT IN 2016

2.1 HUNGARIAN ECONOMY IN 2016[1]

Figures	2014	2015	2016
GDP increase (%)	4.0%	3.1%	2.0%
Industrial production growth (%)	7.6%	7.4%	0.9%
Consumer prices (%)	-0.2%	-0.1%	0.4%
Unemployment rate (%)	7.7%	6.8%	5.1%
Budget deficit (billion HUF)	-826	-1,237	-848
Current balance of payments (million EUR)*	2,356	3,713	4,245
National Bank of Hungary base rate (%, end of the year)	2.10%	1.35%	0.90%
EUR exchange rate (end of the year)	315	313	311

** contains data of the first 3 quarters in case of 2016*
Source: NSA, National Bank of Hungary, Ministry for National Economy

In 2016 continuously retrograded impulses reached the Hungarian economy because of foreign demands. On one side the European, which is determining for the country, and the American economy, that usually is a world leader in cyclical improvement, couldn't show an improvement in their growth (only reached a 2% growth rate). On the other side the rise of emerging economies (with China in the lead), which are the motor of growth of the world economy, has declined. These negative effects have been balanced out with the favourable environment of external financing. This includes the lower return environment which was the result of monetary facilitation in the European Union and slower procession of planned aggravations in America. In the beginning of 2016 the fall of energy prices, that caused betterment in term of trades, also helped to improve Hungary's external balance and vulnerability indicators.

The growth of the Hungarian economy slowed from 3.1% (in 2015) to 2% by the end of 2016, which was due to the loss of cyclical EU resources (2007-2014) and to struggle of industry, while the weather-based agriculture performed well throughout the year. The domestic production contributed strongly to the growth rate, thanks to the upturn in demands in the service sector. The growth in domestic demands could have also been seen in the fact that households became the driving force in consumptions. This was thanks to the still significant raise in real wages (over 7%), the continuous improvement in the labour market (unemployment rate dropped from 6.8% to 5.1%) and the jump in consumers' trust. On the other hand the contribution of export barely rose, because the processing industry – mostly the auto industry -, which has been scaled up in recent years, reached its production capacity, while the upgrades on models produced in Hungary may have also resulted in the reduction of output.

The economy growth continued to go on with advancement in the balance condition. The general government controlled its expenses disciplined (the reduction in interest expenditures also helped), while accomplished great surpluses in income, which was mostly thanks to the growth in income- and value added taxes in an improving economic environment but the reduction in grey market and new types of taxes (such as road toll) also contributed to the revenue gain. The public deficit stayed under 2% of GDP throughout the year, which is the lowest in recent years. As a result the sovereign debt continued to decrease without the need of larger financial manoeuvres and ended at 74% of the GDP by the end of 2016. The outer balance indicators also showed great improvements. The outer net financial capacity jumped from 8% of the GDP in 2015 to 8.5% by the end of the fiscal year, which was mostly due to growth in surplus of goods- and service trades and the improvement in income balance, while the net resource flow of EU has fallen. The improvement in Hungary's position is also shown in the decrease of foreign loans: the gross foreign debt containing the so-called other capital (the loans between the company and subsidiaries) sank under the 100% of GDP by the end of 2016 and the net foreign debt dropped to near 14% of the GDP.

[1] Based on reports and statistics of NBH and HCSO (Hungarian Central Statistical Office), and on analysis of Bank of Hungarian Savings Cooperatives Co. Ltd.

The growth of economy didn't result in a strengthening in inflationary pressures. Although the inflation in terms of 12 months period reached 1.8% in 2016 because of basic effects, the average throughout the year only stayed at 0.4% low. The underlying inflation's value was 1.5% which indicates that the decreased inflation was caused not only by effects outside of energy prices and other monetary decisions. This rate is quite far from the 3% mid-term goal the central bank issued. As a result the Hungarian National Bank (HNB) – also encouraged by the regressive yield environment in Europe – decreased the base rate of the central bank by 45 bp to 0.90%, after what he stayed on the route to ease monetarily using his other tools. Through the self-financing program the free sources of banks has been moved from three-month bank deposits to sovereign debt markets providing swaps of interest rates with preferential fees. This resulted in the short-term yields of government securities and interbank rates to hit rock bottom and in the stabilization of long-term government bonds. Meanwhile the HNB continued the Loans for Growth Program (NHP) that was first introduced in 2013 and has been renewed ever since. Through this program over HUF 2,652 billion has been issued to small and medium-sized enterprises (HUF 526 billion in 2016) with preferential-termed investment loans.

In 2016 the Hungarian forint was able to keep its stability that it acquired in the previous year. Throughout the year it was moving in a shallow line and its yearly average against the euro ended at a slightly weaker 311 position than in 2015. What is more important that its volatility has decreased compared to those emerging currencies (eg. Turkish lira, South-African rand) whose risk group the forint was also part of just a few years ago. Debt risk of Hungary has been drastically reduced due to a decrease in foreign currency loans, a much improved foreign balance indicators and a strong economy growth which resulted in the strengthening of the forint and a change in the country's credit rating. In 2016 all three big credit rating enterprises have upgraded Hungary's credit rating to "stable", which is investment-grade level.

The total number of dwelling construction permits issued and simple declaration concerning the construction of new dwellings show significant growth compared to previous year and number of new housing constructions increased too in relation to preceding year. Number of issued residential building permits and simple declarations increased to 31,559 in 2016, by 152.2% more than in 2015. The most intense increase was recorded in South Transdanubia and in Central Transdanubia (+290.2% and +232.6% compared to 2015, respectively.) The number of planned new homes in Budapest increased by 195.4% to 8,953 - in a measure significantly exceeding changes at country level. Building permits issued in the county seats grew by 184.7% to 8,953, while in other towns an increase of 136.6%, in villages 78.0% was observable compared to 2015.

The number of new homes built increased by 31.3% from 7,612 to 9,994 in 2016. Compared to the number of flat construction in the preceding year a decrease could be seen merely in Southern Transdanubia (18.15%). In terms of territorial units the number of flats built increased in Budapest by 44.0%, in county seats by 48.5%, while in other towns by 19.8%, in villages by 11.34%, compared to 2015. The proportion of flats built by enterprises grew from 39.4% to 49.6% (4,958 pcs); while the proportion of flats built by natural person decreased from 58.5% to 48.5% (4,852 pcs). Among others in consequence of realignment among main contractors the average territory of flats brought into use was 101 sq.m. last year, which decreased to 94 sq.m. by 2016.

2.2 THE BANKING SECTOR IN 2016[2]

Total assets of credit institutions amounted to HUF 34.185 billion at the end of 2016, 4.0% higher than at the end of 2015. According to preliminary data, the cumulative pre-tax profit was HUF 510.3 billion in 2016, significantly better than the HUF 34.3 billion profit of 2015. Out of 111 credit institutions the pre-tax profit of 76 credit institutions was HUF 572.2 billion, while the pre-tax loss of 35 credit institutions was HUF 17.0 billion. Credit institution branches made HUF 46.7 billion pre-tax profit.

Gross loan portfolio of credit institutions increased by 9.2% in 2016. Volume of household's loans increased continuously during the year, representing 3.2% grow that resulted mainly from the execution of Settlement Act. The volume of housing loans decreased by 2.8% during the year.

12.6% (HUF 714 billion) of total gross HUF household loan portfolio (HUF 5,650 billion) was past due more than 90 days at the end of 2016. Among household loans the share of non-performing loans was 16.7% (at the end of 2015 was

[2] Based on - in case of 2016, preliminary - reports and statistics of NBH.

22.3%) and share of loans past due more than 90 days decreased to 12.7% from 17.6% in 2015 that shows the improvement of household loan portfolio. After HUF conversion 25.3% of remaining HUF 45 billion household FX loans was past due more than 90 days compared to 38.5% on 31 December 2015.

In case of non-financial corporations' HUF loan volume (HUF 3,398 billion) 5.4% was past due more than 90 days that also shows an improvement compared to 8.4% at the end of 2015.The proportion of all past due loans among forint loan portfolio was 9.8% as of 31 December 2016, at the end of 2015 it was 112.0%.The 5.5% of the 2,519 billion total FX loan portfolio was past due more than 90 days, which represents decline compared to 10.9% at the end of 2015.

The restructured loans amounted to HUF 1.698 billion at the end of the year lower by 24.9% of the 2015th year-end level. 38.1% of restructured HUF loan portfolio fell into arrears, 13.9% within 90 days, while 24.2% over 90 days.

The share of deposits of the funding of the sector grew in 2016 (53.8% from 51.5% in 2015) amounted to HUF 18,386 billion. Household's deposits represented 39.4% of total deposits.

2.2.1 Retail savings

According to the statistics of National Bank of Hungary, households' financial savings were HUF 24,806 billion as of December 31, 2016, which is 6.1% more (HUF 1,433 billion higher) than a year ago. The structural rearrangement of savings - thanks to declining deposit interest rates - has intensified over the year: households preferred securities instead of savings deposits. Accordingly, the ratio of deposits in the structure of savings deposits changed from 33.1% to the end of the year 2016, 32.2%. The investment funds and other securities present the 36.7% of total savings, compared with the 35.8% of at year-end 2015. Volume of deposits slightly increased by 3.2% during a year; while investment funds fall by 1.5% and other securities increased by 18.8%.

Within the deposits, the volume of current account deposits increased dynamically, by 19.8% year on year; as a result its proportion rose to nearly 55.1%. Other deposits reduced by 11.8% to HUF 3,581 billion. The share of HUF deposits of retail deposits was 84.2%, and FX deposit was 15.8% at the end of December 2016 representing a slight increase in FX deposits compared to a year before.

2.2.2 Retail mortgage lending

Although the disbursement of retail mortgage loans shows increase quarter-on-quarter in 2016 until the end of third quarter, in the fourth quarter a slight decrease can be seen. The yearly disbursement amounted to nearly HUF 490 billion, which volume (HUF 487.8 billion) is significantly higher than in previous year (HUF 399.7 billion), the increase is 22.1%.

2.2.2.1 Mortgage loan volumes

Based on data published by National Bank of Hungary, volume of retail mortgage loans amounted to 4.342 billion HUF as at 31 December 2016. Volume decreased by HUF 380 billion compared to year-end data of 2015 (4.722 billion HUF). Volume of FX loans fell by 16.2%, and HUF denominated loans by 8.0 %, total volume of mortgage loans decreased by 8.0%.

Volume of housing loans amounted to HUF 2,923 billion as of 31 December 2016, representing yearly decrease of HUF 84 billion. HUF loans fell down by HUF 83 billion and FX housing loans fell down by HUF 1 billion during a year.

General-purpose mortgage loans amounted to HUF 1,419 billion as of 31 December 2016 with a HUF 294 billion year-on-year decline. Decrease of HUF-denominated general-purpose loans grew by HUF 291 billion, at the same time FX-based general-purpose loans were down by HUF 3 billion.

FX loans, proportion of FX mortgage loans decreased from 0.5% in 2015 to 0.4% as of 31 December 2016.

2.2.2.2 Home protection measures

National Asset Management Ltd.

Among the steps of the 'Home Protection Action Plan' can be found the establishment of the National Asset Management Ltd. (NET). to purchase the properties of the most indigent debtors. The related Act CLXX of 2011 provides details about the criteria and the process of the purchase of the properties ensuring residence to the indigent debtors by NET. After 20 June 2012 the properties can be offered for the NET without marked as available for forced sale. The purchase price of the properties is determined by the NET as 35-55% of the original market value depending on the size of the town.

Thanks to the modifications of the Act CLXX of 2011 in December 2012, and July 2013, and also to the regulatory changes entered into force on 1 September 2015 affecting the NET program; the number of the entitled customers was expanded.

The initiation to get the entitled customers in the program is continuous, however NET Ltd. – with regard to the law limited size of buyable estates – should accept new requests until the beginning of the year 2017. According to the current information the program will not continue or will not be modified.

Until 31 December 2016 2,066 real estates have been offered for the NET, and behind them there were 3,799 transactions. The NET has paid the purchase price of 1,770 real estates (3,258 loans).

Personal bankruptcy

The CV law related to the debt settlement of natural persons (the so called „Personal bankruptcy law") entered into force on 1st of September 2015. The main aim of the law is to settle the debt of natural persons facing payment difficulties using the necessary property and incomes, and to restore the solvency of natural persons in the regulated framework of extrajudicial and judicial procedure of the debt settlement law. The Bank has 48 Debt Settlement Proceedings at this time.

2.2.3 Family Housing Allowance ('CSOK')

Family Housing Allowance (CSOK) has been available since 1 July 2015, as its predecessor it still aims to support families with children to purchase homes, but it contains significant improvements compared to the earlier social housing subsidy. The non-refundable single subsidy granted by the Hungarian State is available for buying or building new housing, and also for buying second hand homes and for expansion. The amount of the allowance depends on a number of factors: the number of children and the size of the property and its energy efficiency rating.

From 30 June 2015 the FHB Group was among the first to start with the new CSOK available for a wider group of people than heretofore; there was a large demand for the new type of subsidy during the year.

By the end of 2016 more than 2,400 loan applications had been approved, from which the number of disbursed loans reached 1,700 with the total volume amounting to HUF 4.4 billion. In case of 50% of 'CSOK' applications clients submitted loan applications as well.

2.2.4 Other retail loans

Consumer loans of households have been increasing in 2016, as well. Increase in volume was 3.5%, and the main fall appeared in case of car purchase loans and of credit card loans, while volume of consumer loans for purchase of goods or other and of personal loans increased. Personal loans representing 40.8% of consumer loans; contribution of overdrafts reached 18.9%.

2.2.5 Corporate loans and deposits

Loans granted by credit institutions to non-financial corporations decreased by 12.2% in 2015, the year-end closing stock of HUF 5,937 billion. Within the total stock of loans foreign currency loans decreased by 17.2% while HUF loans by 7.4%.

The Central Bank of Hungary announced the Funding for Growth Scheme in April 2013, with the total of HUF 750 billion. The first two pillars of the program were designed for small and medium-sized enterprises to facilitate access to HUF loans and thereby strengthen financial stability.

From October 2013, the program continued. Under the Funding for Growth Scheme II total amount of HUF 2,000 billion is at disposal of credit institutions, but 90% of the allocation of the first HUF 500 billion could only be used to provide new loans. In the second stage stock increase was hardly more than HUF 29 billion by the end of 2013, so in 2014 its availability has been extended (lending for primary producers/farmers and family businesses, increasing the maximum amount of credit per customer, subsidizing for-profit property development, engaging financial institutions).

In the second phase of the Scheme until 31 December 2015 credit institutions reported contracts, amounting HUF 1,402.1 billion to the NBH, which is linked to 45,977 units and 26,745 transactions. The second phase of the Scheme closed at the end of 2015, the third Scheme starts in 2016.

In the third phase of the Scheme until 30 December 2016 NBH has received data of contracts amounting to HUF 1,402.1 billion, which is linked to 16,628 units and 11,024 transactions. 76.5% of these units was new investment loan, while 23.5% was new leasing (in the third phase only these types of financing were available).

Corporate deposits amounted HUF 6,582 billion at the end of 2016, within 79.8% is the ratio of current account deposits. The share of foreign currency deposits of corporate deposits was 30.4% on 31 December, 2016.

3 REPORT ON THE BUSINESS ACTIVITIES IN 2016

3.1 MAJOR FINANCIAL INDICATORS

in HUF billion	31/12/2015	31/12/2016	Change
Balance sheet total	744.8	593.4	-20.3%
Book value of loans	397.6	349.7	-12.0%
Mortgage bonds issued	194.5	143.1	-26.4%
Bonds issued	60.5	39.1	-35.3%
Deposits	329.0	297.1	-9.7%
Shareholders' equity	108.5	57.6	-46.9%
Own funds	66.5	45.6	-31.4%
Total risk exposure amount	330.1	332.6	0.8%
Capital adequacy ratio (IFRS, %)	20.13%	13.71%	-6.4%-pt
Profit before tax	-7.7	-9.3	20.8%
After tax profit	-10.5	-15.5	47.6%
After tax profit excluding special banking tax and one-offs	-4.0	-2.5	-37.5%
Average net interest margin (NIM, %)	1.93%	1.83%	-0.1%-pt
Cost/income ratio w/o other results (CIR, %)	88.1%	78.8%	-9.3%-pt
EPS (HUF)	-126.3	-102.1	-19.2%
ROAA (return on average assets, %)	-1.4%	-2.3%	-0.9%-pt
ROAA excluding special banking tax (%)	-1.0%	-2.1%	-1.1%-pt
ROAE (return on average equity, %)	-10.7%	-18.7%	-8.0%-pt
ROAE excluding special banking tax (%)	-7.9%	-16.7%	-8.8%-pt

FHB Group's consolidated balance sheet total calculated according to International Financial Reporting Standards (IFRS) was HUF 593.4 billion as of 31 December 2016, which was 20.3% and HUF 151.4 billion less than a year before. In the last year, primarily the volume changes of due from banks and NBH generated the decrease of balance sheet total on the asset side, while among the liabilities issued securities and deposits decreased most of all. Net amount of loans decreased by HUF 45.2 billion or 12.2% in one year, of which decline in refinanced loans was 62.0%.

On the liability side issued securities, deposits and shareholder's equity decreased significantly, and this decrease could not have been compensated by more than 18% raise in due to banks.

Consolidated profit after tax for 2016 was HUF 15.5 billion losses; net interest income amounted to HUF 12.3 billion. Net interest margin on average assets was 1.83%, by 10 basis points down year-on-year.

The Group's cost to income ratio without other results was 78.8% compared to 88.1% in 2015.

On 24 June 2016 the Bank repurchased subordinated Tier 1 capital bond with XS0867086042 ISIN code with a nominal value of EUR 112 million. Among other factors due to the repurchase the shareholders equity decreased by 46.9% to 57.6 billion during the year. The accumulated losses of shareholders of the Bank amounted to HUF -11.0 billion. The capital adequacy ratio was 13.71% at the end of the year.

3.2 LENDING

The volume of gross loans of FHB Group amounted to HUF 318.3 billion as of 31 December 2016. Year-on-year increase was 1.1%, due to the intensively growing disbursements, which can compensate contractual instalments.

The rate of FX loans of total outstanding loan portfolio was 10.4% as of 31 December 2016, which is higher than the 7.8% figure in previous year. The share of FX loans in retail loans was 1.0% which shows significant decrease compared to the end of the previous year (1.3%).

Retail loans continued to dominate within the loan portfolio with a contribution of 65.0% (71.0 % on 31 December 2015). Changes in the composition of the loan portfolio are a result of the retail loan portfolio showed decrease of HUF 16.6 billion (-7.4%) year on year, while the volume of corporate loans grew by 22.0% or HUF 20.0 billion.

The composition of the loan portfolio of 31 December 2016:

in HUF million	31/12/2015	31/12/2016	Change
Retail loans	**223,584**	**207,009**	**-7.4%**
Housing loans	118,120	112,930	-4.4%
Other mortgage loans	94,564	78,852	-16.6%
Consumer loans	6,871	11,190	62.9%
Loans for employees	1,306	1,299	-0.5%
Retail real estate leasing	2,724	2,738	0.5%
Corporate loans	**91,271**	**111,317**	**22.0%**
Corporate loans	87,862	104,076	18.5%
Corporate real estate leasing	1,397	2,120	51.8%
Equipment leasing and loan	2,012	5,121	154.5%
Total own lending, gross	**314,855**	**318,326**	**1.1%**
Impairment	-26,557	-23,853	-10.2%
Loans, net	**288,299**	**294,473**	**2.1%**
Refinanced loans	82,790	31,423	-62.0%

During 2016, HUF 24.3 billion retail and HUF 56.1 billion corporate loan disbursements occurred, latter is 30.8% higher than in 2015. In 2016 the Bank placed HUF 4.9 billion loans out to corporate customers within the framework of Funding for Growth Scheme. Among corporate loans the disbursement of fixed purpose loans was outstanding (HUF 35.3 billion during twelve months), which shows 112.3% increase in 2016 compared to the same period of previous year. The most significant retail products were housing loans and personal loans, the disbursement during the year was HUF 15.6 billion in case of first product, while in case of latter HUF 4.8 billion. During 2016 the volume of disbursed housing loans was 32.2% higher than in the same period of 2015, while the disbursement of personal loans remarkably increased too.

In terms of residential mortgage loans disbursement FHB Group's market share was 3.9% in 2016 (4.4% in 2015).

On 20 April 2016 the FHB Commercial Bank Ltd. as a member of the Consortium for Development MFB Points with the Bank of Hungarian Savings Cooperatives Co. Ltd., the B3 Savings Cooperatives and the Budapest Bank Ltd. entered into an Intermediation Contract with the Hungarian Development Bank Ltd. (hereinafter referred to as the "MFB"). Under the Intermediation Contract the Commercial Bank shall participate in the development of the network of MFB Points, and have undertaken to open and operate 3 MFB Points in Budapest and 18 in the chief towns of the respective counties based on its branch network. Entering into the Intermediation Contract is a unique opportunity to expand on the corporate market; interest-free credit facilities for developments will be widely available for corporates with a plan to expand, and the entire product range of the Commercial Bank shall be available to supplement the necessary funds. For the end of June, FHB Commercial Bank Ltd. opened the 21 MFB Points undertaken on the contract with the Hungarian Development Bank Ltd. (MFB). During the year there was a huge interest toward the interest-free credit facilities for developments.

3.3 REFINANCING

By 31 December 2016 consolidated volume of refinanced loans dropped by 62.0% in one year to HUF 31.4 billion.

The Mortgage Bank and the Hungarian Branch Office of AXA Bank Europe SA (and its predecessors) had a refinancing cooperation since 2004 that terminated by 1 November 2016, because the total mortgage loan portfolio of the Hungarian Branch Office of AXA refinanced by the Mortgage Bank has been assigned. In accordance in the last quarter of 2016 the outstanding HUF 35.5 billion refinanced debt has been repaid which resulted in a drop in refinanced loans and in the change of structures of interest earning assets.

During this year the Mortgage Bank started the preparation of introducing the Mortgage Financing Adequacy Ratio (JMM), resulting in some new refinancing agreements with new partners.

3.4 CUSTOMER DEPOSITS, BANK ACCOUNT SERVICES

At the end of 2016 the Commercial Bank had 41 branches countrywide, which performed all of the retail bank services. There are 14 branches in Budapest, the others located in other county seats and major cities.

The number of retail and corporate accounts managed by the Commercial Bank was 211.0 thousand and 12.1 thousand, respectively, to which belonged 170.4 thousand retail and 6.7 thousand corporate cards – both number of current retail accounts and number of retail cards increased compared to the previous year.

Volume of retail deposits increased by 1.5%, while corporate deposits fell down by 16.8% compared to 2015. Total volume of deposits decreased by 9.7% year-on-year and amounted to HUF 297.1 billion as at 31 December 2016. Volume of retail sight deposits reached HUF 66.4 billion, while corporate sight deposits amounted to HUF 73.4 billion, respectively at the end of the year, reach close to 47.1% share of sight deposits from total deposits.

Under the agreement between FHB Mortgage Bank and the Magyar Posta Zrt., the Company signed an order contract with Magyar Posta Zrt. for certain financial mediation services. Under the agreement, the Hungarian Post Office network sells from the beginning of December 2013, an expanding range of products on retail term deposits and retail accounts. The deposit volume sold by post offices was nearly HUF 42 billion for the end of 2016. The number of accounts collected in the Hungarian Post offices reached nearly 67 thousand at the end of the year.

3.5 INVESTMENT SERVICES

FHB Bank Ltd. investment services business continued to grow in 2016. Due to successful customer acquisitions the term and long-term investment account openings showed a significant increase, the number of securities accounts managed by the Bank exceeded 12,700 at the end of the year (+5.8%). The favourable market environment was beneficial for the sale of mutual funds and private bonds, which contributed to private and business customers registered accounts stocks market value exceeded HUF 80 billion by the end of the year 2016 (more than 11% growth compared to 31 December 2015).

In the securities segments, in addition to its own specially issued debt securities to retail investors, mutual funds played an important role in the product portfolio. These volumes at the end of the year was HUF 30.9 billion, representing a 38.6% stake in the managed assets. Among the private debt securities bonds have the largest portion with HUF 7.0 billion, the value of sold shares was HUF 6.4 billion. The interest for mortgage bonds significantly weaken, the stock was HUF 5.4 billion at the end of the year compared to HUF 6.6 billion in 2015. Government securities showed a significant increase, the volume increased to HUF 29.8 billion at the end of 2016 from HUF 20.5 billion as of 31 December 2015.

For bonds and covered bonds issued by FHB Mortgage Bank, FHB Commercial Bank carries out continuously secondary market quotations on both sides, for both corporate and retail clients, which significantly increases the liquidity of the securities issued by the Bank Group.

Concerning the funds managed by Diófa Asset Management, by the end of December 2016, volume of Hungarian Post Takarék Money Market Fund sold in the network of FHB Bank Ltd neared to HUF 2.8 billion, while Takarék FHB Short Bond Fund volume reached HUF 2.7 billion. Net asset value of Hungarian Post Takarék Harmony Mixed Investment Fund managed on client accounts amounted to HUF 531 million, while the volume of Takarék FHB Euro Real Estate Fund was HUF 725 million. The Commercial Bank also distributes the investment units of the Hungarian Post Takarék Real Estate Funds, these stocks held by FHB customers nearly exceeded HUF 18.3 billion.

3.6 SECURITY ISSUES

3.6.1 Mortgage and Senior bond issues

In 2016 FHB Bank made 9 transactions and issued mortgage- and senior bonds with the value of HUF 45.8 billions.

In 2016, the Bank has HUF 45.8 billion new capital market funds (euro funds calculated at the EUR exchange rate as of the date of the issuance). The face value of issued bonds amounted to HUF 44.2 billion mortgage bonds and HUF 1.6 billion unsecured bonds were issued.

3.6.2 Mortgage bond coverage[3]

In accordance with the relevant statutory provisions the Bank has undertaken to keep a stricter mortgage bond coverage ratio. Accordingly, the aggregate amount of ordinary collateral (net of loss in value) plus supplementary collateral principal exceeded each day the aggregate nominal value of outstanding mortgage bonds in circulation. The same adequacy rule prevailed with respect to interest-to-interest.

In accordance with the provisions of the Act on Mortgage Loan Companies and Mortgage Bonds and in keeping with its Rules on Collateral Registration, the Bank monitored the loan cover situation and the compliance with the requirement of proportionality. In order to ensure appropriate mortgage bond cover the Bank verified, upon disbursement of the loan, whether the conditions for ordinary collateral were met.

The net collateral value of real estate covering mortgage bonds issued by the Bank was HUF 227.6 billion as of 31 December 2016, 22.2% less than the figure as of 31 December 2015 (HUF 292.6 billion).

Value of mortgage bonds and assets involved as collateral as of 31 December 2016

in HUF million	31/12/2015	31/12/2016	Change
Outstanding mortgage bonds in circulation			
Face value	195,084	153,385	-21.4%
Interest	40,676	28,328	-30.4%
Total	**235,760**	**181,713**	**-22.9%**
Value of the regular collateral			
Principal	207,402	170,890	-17.6%
Interest	85,178	56,718	-33.4%
Total	**292,580**	**227,608**	**-22.2%**
Value of assets involved as supplementary collateral			
Government and Hungarian Development Bank bonds	17,007	8,001	-53.0%
Total	**17,007**	**8,001**	**-53.0%**

As of 31 December 2016, the present value of ordinary collateral was HUF 203.5 billion and the present value of mortgage bonds was HUF 177.5 billion, thus the present value of collateral exceeded that of CMBs (Collateralised Mortgage Bond) in circulation not yet repaid. The combined present value of collateral to the combined value of mortgage bonds in circulation was 114.6% in the same period.

As of 31 December 2016 net value of ordinary and supplementary collateral principal to the unpaid face value of mortgage bonds in circulation was 116.6%, and the net ordinary and supplementary collateral principal to the unpaid interest on mortgage bonds in circulation was 200.2%.

[3] Non-consolidated data of FHB Mortgage Bank Plc. only, according to HAS

4 LIQUIDITY MANAGEMENT

In accordance with the Group's strategy the Mortgage Bank ensures the entire Group's liquidity through regular business relations with other Group companies.

The Group's liquidity position was constantly stable in 2016. Treasury Department managed FHB's liquidity in the examined period in accordance with the Group's liquidity management framework established in the past. Stable background and existing solvency have been characteristics of all Group members. In June there was a higher distrust in investors than usual - different than the fluctuation of deposits in the bank sector – caused by news articles which resulted in the withdrawals from deposits by institutional investors and big companies. This had a significant effect on the level of the deposits in FHB. Because liquidity management is prepared for such deposit withdrawals and these deposits are invested in liquid assets, these outflows didn't cause any liquidity issues. The stress in the environment has declined during the summer and in the fourth quarter it terminated, which resulted in the restoration of the investors' trust. As a result the amount of deposits started hiking and according to its trend it will shortly reach its degree from before June.

During management of the group's liquidity – due to the fact that the new supervisory standards (LCR, LCRDA) don't support the aggregation and consolidation of positions – transactions in the money and capital markets will carry out in a more complex way to meet the liquidity standards. The adaptation to regulatory environment and the optimisation to worth indicator expectations resulted in the establishment of both banks in the open market regarding certain products and types of businesses. The Treasury Department of Mortgage Bank, as the professional leader, managed the positions safely and also supervised Commercial Bank's independent activity in compliance with referring limits and regulations.

The closing balance of the nostro accounts of the Group was HUF 16.3 billion, in Mortgage Bank this amounted to HUF 1.6 billion.

The amount of margin deposits of the Group in HUF was HUF 2.2 billion (Mortgage Bank HUF 0.3 billion), in EUR in FHB Commercial Bank it was EUR 3.54 million and the net margin position of the Mortgage Bank's deposited interbank showed a net balance of EUR 3.91 million and HUF 100 million at the end of 2016. The Group's net margins placed with counterparties amounted to EUR 7.45 million (about HUF 2.3 billion) and HUF 2.3 billion, ie. a total of HUF 4.6 billion.

As of 31 December 2016, the consolidated securities portfolio contained mainly government bonds (HUF 47.1 billion, EUR 12 million and USD 0.6 million), and state guaranteed securities (HUF 32.6 billion, EUR 25 million and USD 2.33 million) and lesser extent other institutional / corporate bonds (HUF 588.7 million, EUR 24.4 million, USD 8.6 million). (The portion of the securities held by the Mortgage Bank - HUF 28.5 billion government bonds and HUF 10 billion securities with a state guarantee –are held solely due to liquidity and risk management purposes.)

Available liquid securities of the Group amounted to HUF 180.0 billion (including exclusively the unencumbered security portfolio, nostro accounts, net overnight interbank- and overnight NBH deposits).

5 RISK MANAGEMENT PRINCIPLES

5.1 RISK MANAGEMENT POLICY

The FHB Group's enterprises under the prudential consolidation and control of the FHB Mortgage Bank are also parts of the group under consolidated supervision of the Takarékbank as parent bank, moreover the FHB Mortgage Bank and the FHB Commercial Bank are members of the Integration Organisation of Cooperative Credit Institutions (SZHISZ).

Pursuant to the Integration membership and the consolidated supervision the risk management regulation and also the risk strategy of the Integration applies to the FHB Banking Group.

The mandatory Risk Strategy used by the financial institutions and the corporates under the consolidated supervision approved by the Board of Directors of the Takarékbank covers the following topics: risk culture, risk taking principles, targets, risk types, essential risks, risk appetite, risk tolerance, risk structure, risk management, structure and the organisation of the risk management.

The Integration and its members are striving to create an integrated risk culture covering the whole Integration, supporting the risk identification, measurement and management in accordance with their risk appetite and risk tolerance. The primary tools of the risk culture to be introduced are the elaboration of the inner strategy, regulations, guidelines, the communication and the education of the employees.

In the Integration the FHB Mortgage Bank Co. Plc. is the leading credit institution of the subconsolidated FHB Banking Group. In order to achieve the strategic goals of the Banking Group the FHB Mortgage Bank as parent bank has a twofold – ownership and professional - control over the group members owned directly or indirectly. In the framework of the professional control the FHB Mortgage shall ensure, that the risk management principles, methods, the risk evaluation, measurement and control procedures should be consistent, and harmonized and at the same time should be in compliance with the risk regulation of the Integration.

The primary goal of the risk management is the protection of the financial strength and good reputation of the Banking Group, and the contribution to the utilization of the capital in competitive business increasing the shareholder value. The protection of the financial strength and good reputation means, that the risk management limits the impact of the adverse events on the Group's capital and profit.

The risk tolerance of the Banking Group must be harmonised with the financial resources available for hedging the potential losses. The Banking Group calculates the present and future economic capital needs and the Pillar I. capital requirements relating to quantifiable risk types.

The Banking Group considers the prudent risk taking as a fundamental value.

The Group faces basically credit-, liquidity-, market and operation risks.

5.2 CREDIT RISK

In the field of credit risk management the following tasks - apart from contribution to risk-taking related decisions with analyses and daily routines of participating in decision-making – completed by the Banking Group in 2016 can be highlighted:

Corporate Division's sectorial limit structure was updated in Q1 2016, which set the directions of risk taking. The directive aiming at managing the corporate clients' FX exposures was completed in Q3 2016, which the Group is expected to implement in the near future.

The aims of the directive:

- Accurate presentation of business processes related to corporate clients' FX exposures (speculation, natural exposure, hedging etc.). FX risk analysis and determining the denomination of lending have to be integral parts of risk-taking process.
- Defining the minimum requirements and conditions for lending clients in foreign currency and determining risk management tools for managing clients' actual FX exposure.
- Monitoring of corporate clients' business activity in relation to FX exposures (speculation, natural exposures, exposures originating from funding structure, hedging) has to be integrated into the monitoring/review process.
- Summarizing special contractual clauses in relation to foreign currency lending.

For the retail customer base the main tasks were the participation in the set-up and restructuring of internal processes and rules required by:

- compliance to regulation, such as the CSOK decree issued by the government; amendment of the law on lending to retail customers; actualization of rules on income verification in line with the referring NBH decree
- product development, such as the accelerated approval process of FHB personal loan; the product development of Posta Premium personal loan, amendment of rules of the debt restructuring personal loan; introduction of Car and Home restoration personal loan product

As a result of Risk Management Division's initiative and coordination, rules of decision-making and responsibilities were amended and introduced after the approval of the management. These amendments include clarifications, while FHB introduces a power for corporate risk taking dependent on client qualification.

5.3 LIQUIDITY AND MATURITY RISK

Maintaining liquidity is an essential element of the banking activity. The Bank maintains its liquidity by coordinating the maturity of its assets and liabilities. In the framework of ALM activity the Bank mitigates the maturity risk through the repurchase of the securities issued and new issuances. At the same time, it applies maturity transformation regulated by limits in order to improve profitability while maintaining solvency at all times. The Bank regularly reviews prepayments initiated by clients prior to term and takes into consideration their impact on managing market and liquidity risks.

FHB Group seeks to diversify its sources with respect to type of resources and distribution channel. In addition to the issue of capital market instruments addressing institutional investors, deposits are collected and securities sold in its branch network as well as in the network of Hungarian Post.

The Group's liquidity plans, financial position are prepared along scenarios based on different assumptions, which take into account the effects of stress situations. The stock of liquid assets is constantly high.

5.4 EXCHANGE RATE RISK

The Mortgage Bank is a specialized credit institution, which narrows the scope of business where exchange rate-related risks may arise. Moreover, the Bank's business policy is to keep exchange rate risk at a low level.

The Banking Group intends to immediately hedge the exchange risks related to its core business, as allowed by market circumstances. Therefore, an open FX position may occur primarily due to liquidity management, settlements related to lending and refinancing, or active and passive provisions in currencies in which the Bank keeps nostro account.

5.5 INTEREST RATE RISK, EXCHANGE RATE RISK

Interest rate risk stems from interest rate changes, which affect the value of financial instruments. The Bank is also exposed to interest rate risk when the amounts of assets, liabilities and off-balance sheet instruments maturing or re-priced in a particular period are not in accordance with each other.

The Bank is monitoring the interest rate risk on a continuous basis by Gap analysis, VaR calculations and sensitivity analysis and mitigates by setting limits. The Bank manages market risk mainly by natural hedging. In addition, active management tools such as repurchase of mortgage bonds, swap transactions as well as mortgage bond maturities and interest rates corresponding to assets are involved in order to ensure the harmony between assets and liabilities.

The Bank manages the risk related to investment services through setting limits.

5.6 OPERATING RISK

The Bank manages operational risks by developing and improving internal rules and regulations, by providing appropriate training to the staff involved in the workflows and by creating and developing further built-in control mechanisms. The Group collects and analyses loss data of operational risk and Key Risk Indicators (KRI). KRIs are reviewed annually. In 2016 more KRIs have been modified and new ones has been defined and introduced.

On the basis of the annual self-evaluation of potential operational risk factors arising from the activities the Group put together and update operational risk map, and identify rare events with high losses, which events' impacts are assessed by the scenario analysis.

The Bank has created the Modell inventory in sync with supervisory expectation which was filled with the help of involved departments.

5.7 OTHERS

In the Q2 2016 the institutional members of the FHB Banking Group have fully met the transparency requirements of CRR and published the mandatory information about the risk management, the capital adequacy and the remuneration policy.

The co-workers at the risk management department took active part in the project with the goal to construct the United IT System of the Integration.

6 ORGANIZATIONAL CHANGES AND HEADCOUNTS

In 2016 several organizational changes took place in the Banking Group, in case of Commercial Bank and Mortgage Bank as well.

The FHB Mortgage Bank held its annual general assembly on the 28th of April in 2016. During this meeting Levente László Szabó has been elected as a member of the board of directors, while Miklós Szabó and István Sebestyén have been chosen as member of the supervisory committee and the audit committee.

Dr. Zoltán Spéder, the chairman of the board of directors has resigned on 14th October 2016.

The board of directors has called on an extraordinary meeting after a stockholder with at least 1% of the vote rights proposed it. On 21st of November 2016 all members of the board and the supervisory committee have been recalled from office. At the same time dr. Erik Landgraf, Mátron Oláh, Attila Mészáros, Gábor Gergő Soltész and József Vida has been elected as members of the board, while dr. Kadosa Antal, sr. Zsolt Harmath, dr. Mónika Kovács, György Pórfy and dr. Balázs Reiniger have been chosen as members of the supervisory committee for the Company.

At the constituent sitting the board selected József Vida as chairman on 5th of December 2016.

Gyula Köbli has been recalled from his position as chief executive officer on 5th of December 2016 and Márton Oláh has been elected into the position.

The restructuring of the FHB Commercial Bank's organization started at 1 January 2016, because the existing organizational structure didn't allow the integrated sales approach governance, and the effective performance of expanded functions. In order to more optimal operation, organisational units have transformed, have divided, broadening the organisational structure. This change mainly affected the apparatus of two departments controlled by the Deputy Corporate CEO and by the Deputy Capital Market and Treasury CEO.

As of December 31, 2016, the consolidated full-time headcount was 995.8; by 131.8 (15.3%) more than headcount of 863.8 as of December 31, 2015.

Headcounts (FTE, year-end) of the Group companies were as follows:

	31/12/2015	31/12/2016	Change
FHB Mortgage Bank Plc.	129.4	132.8	2.6%
FHB Commercial Bank Ltd.	657.4	761.8	15.9%
FHB Real Estate Ltd.	9.9	12.5	26.3%
FHB Lízing Ltd.	14.3	17.2	20.3%
Diófa Asset Management Ltd.	32.1	41.2	28.3%
Diófa Real Estate Management Llc.	8.4	15.8	88.1%
FHB Invest Ltd.	1.1	1.1	0.0%
Hungarian Card Service Plc.	11.3	13.4	18.6%
FHB Group Total	**863.8**	**995.8**	**15.3%**

7 FINANCIAL ANALYSIS[4]

7.1 BALANCE SHEET STRUCTURE

in HUF million	31/12/2015	31/12/2016	Change
Cash on hand	3,017	4,327	43.4%
Due from banks & NBH	210,957	130,924	-37.9%
Securities held for trading	51,913	40,734	-21.5%
Financial assets available for sale	74,042	66,295	-10.5%
Investment in associates (jointly controlled companies)	7,755	4,816	-37.9%
Derivate financial assets	884	933	5.5%
Refinanced mortgage loans	82,790	31,423	-62.0%
Loans and advances to consumers	314,855	318,326	1.1%
Impairment and provision	-26,557	-23,853	-10.2%
Investment property	780	780	0.0%
Tangible assets	6,168	4,942	-19.9%
Goodwill and other intangible assets	1,915	2,042	6.6%
Deferred tax asset	8,232	3,030	-63.2%
Other assets	8,069	8,685	7.6%
Total assets	**744,820**	**593,404**	**-20.3%**
Due to banks	39,774	47,229	18.7%
Issued securities	235,115	170,283	-27.6%
Mortgage bonds	174,591	131,140	-24.9%
Bonds	60,524	39,143	-35.3%
Deposits from customers	329,048	297,072	-9.7%
Derivative financial liabilities	2,308	1,579	-31.6%
Financial liabilities at fair value through profit or loss	19,878	11,991	-39.7%
Finance lease liabilities	12	3	-75.0%
Current tax liability	1	0	-100.0%
Deferred tax liability	1	0	-100.0%
Provisions	999	1,546	54.8%
Other liabilities	9,152	6,099	-33.4%
Total liabilities	**636,288**	**535,802**	**-15.8%**
Share capital	10,849	10,849	0.0%
Share premium	27,926	27,926	-
Treasury shares	-207	-207	0.0%
Subordinated Tier 1 capital	31,749	0	-100.0%
Other reserves	599	609	1.7%
Retained earnings	24,441	12,661	-48.2%
Minority interest	21,479	16,812	-21.7%
Balance sheet profit	-8,304	-11,048	33.0%
Total shareholders' equity	**108,532**	**57,602**	**-46.9%**
Total liabilities and shareholders' equity	**744,820**	**593,404**	**-20.3%**

[4] This financial analysis – considering also investor's needs – contains data and tables calculated from controlling point of view, therefore due to reclassification some figures can differ from data reported in other parts of the consolidated IFRS financial statements.

As of 31 December 2016, the Bank's consolidated balance sheet total by IFRS amounted to HUF 593.4 billion; and decreased by HUF 151.4 billion or 20.3% compared to the value as of 31 December 2015. On the assets side volume of loans increased by more than 1.1%, refinanced loans dropped by 62.0%, interbank lending by 37.9%, while volume of securities held for trading decreased by 21.5%.

Liabilities decreased by 15.8% altogether compared to the reference figures of 2015. Issued securities and deposits from customers showed decrease (-27.6% and -9.7%, respectively), while due to banks increased by 18.7%.

Shareholders' equity decreased by HUF 50.9 billion or 46.9% year-on-year, the main reason of which was the repurchase of subordinated Tier 1 capital bond (EUR 112 million) on 24 June 2016.

7.1.1 Interest earning assets

The Group's interest earning assets decreased from HUF 736.6 billion as of 31 December 2015 to HUF 591.2 billion as of 31 December 2016. Interest earning assets contributed 99.6% to the balance sheet total.

Interbank lending

NBH and other interbank lending decreased from HUF 211.0 billion HUF as of 31 December 2015 to HUF 130.9 billion as of 31 December 2016. The item contributed 22.1% to interest earning assets as of 31 December 2016, significantly increasing to a year before.

Securities

The value of Bank's securities available-for-sale decreased from HUF 74.0 billion as of 31 December 2015 to HUF 66.3 billion as of 31 December 2016. Contribution of securities available-for-sale to interest earning assets was 11.2%. From the stock of securities available for sale discount treasury bills amounting to HUF 22.1 billion and government bonds amounting to HUF 11.5 billion and other bank and corporate bonds for sale amounting to HUF 32.7 billion. As of 31 December 2016, the Bank held a portfolio of securities for trading (HUF 40.7 billion), which contributed 6.9% to interest earning assets.

Loans

As of 31 December 2016, the volume of loans showing an increase by 1.1% compared to the previous year. Impairment to cover loan losses decreased from HUF 26.6 billion as of 31 December 2015 to HUF 23.9 billion as of 31 December 2016.

Volume of refinanced loans dropped by 62.0% to HUF 31.4 billion during 12 months because of the previously detailed AXA prepayment. As of 31 December 2016, the contribution of refinanced loans and gross own lending was 59.2% in total assets; the same ratio was close to 54.0% a year before.

The collateral value of real estate covering ordinary collaterals amounted to HUF 622.8 billion as of 31 December 2016, 11.5% down compared to 31 December 2015 (HUF 704.1 billion). The LTV ratio applicable for ordinary collateral was 27.3% as of 31 December 2016, lower than the 29.3% LTV as of 31 December 2015.

Portfolio quality

In 2016, FHB Group paid special attention to prevent further deterioration of the loan portfolio and cleaning of the portfolio, as well. In customer segment beside participation in the Government's home protection programs, the Bank also aimed to decrease volume of NPL through individual customer agreements.

Offering real estates for entitled clients to NET program continued. 2,066 properties were offered by the Banking Group for NET since the beginning of the program the majority of which were purchased by NET. In consequence of NET sales 469 loan contracts were closed in 2016.

Due to the measures of portfolio cleaning the ratio of non-performing loans significantly decreased by the end of 2016 compared to the previous year. Volume of non-performing loans was 26.8% down compared to the end of 2015. NPL ratio has been shrinking from 14.7% by 31 December 2015 to 10.6% as of 31 December 2016, influencing by decrease in non-performing loan volume and also growing volume of new loans. The Integrational Organization of Cooperative

Credit Institutions (SZHISZ) prescribed for the FHB Group on the rating date of 31 December 2016, that average loss coverage of outstanding loans with overdue over 90 days must reach 70%. Considering this coverage of non-performing loans was 70.4%, which increased by 13.0% points compared to the end of December 2015.

7.1.2 Other assets

Tangible assets amounted to HUF 6.2 billion as of 31 December 2015 and decreased by HUF 1.2 billion year-on-year to HUF 4.9 billion. As of 31 December 2016, intangibles amounted to HUF 2.0 billion, by HUF 0.1 billion or 6.6% higher year-on-year.

Value of investment in jointly controlled companies consolidated by equity method and in associates amounted to HUF 4.8 billion as of 31 December, 2016.

Other assets amounted to HUF 8.7 billion as of 31 December 2016, increasing by 7.6% (HUF 0.6 billion) year-on-year. Deferred tax assets reached HUF 3.0 billion while a significant item in other assets is the value of deposits amounted to HUF 3.5 billion.

7.1.3 Interest bearing liabilities

Interest bearing liabilities HUF 526.6 billion as of 31 December 2016, (HUF 623.8 billion at the end of 2015) represents 88.7% of the balance sheet total. Issued securities and customer deposits gave major part of interest bearing liabilities.

Interbank funds

As of 31 December 2016, interbank funds amounted to HUF 47.2 billion increased by 18.7% on yearly basis. Contribution of interbank borrowings to interest bearing liabilities was 9.0% as of 31 December 2016.

CMBs and Bonds issued

The contribution of covered mortgage bonds – measured at amortised cost and at fair value – to the Bank's interest bearing liabilities was 27.2% as of 31 December 2016, which ratio was 31.2% in 2015. HUF 143.1 billion value of mortgage bonds as of 31 December 2016 was 26.4% down from figures of 31 December 2015 (HUF 194.5 billion). Decrease in the value of the CMB portfolio was HUF 51.3 billion year-on-year.

The book value of bonds (both measured at amortised cost and at fair value) was HUF 39.1 billion as of 31 December 2016. The year-on-year decrease was 35.3%; the volume of bonds dropped by HUF 21.4 billion.

Deposits

As of 31 December 2016, deposits amounted to HUF 297.1 billion decreasing by 9.7% year-on-year. Last year volume of corporate deposits increased whileretail deposits decreased. As retail deposits grew by 1.5%, corporate deposits decreased by 16.8%. From the middle of 2013 retail deposits lost its dominant position among FHB Group's consolidated deposits as share of corporate deposits was around 56.5% at the end of the period. The sight deposit ratio grew from 37.9% to 47.1% in a year.

7.1.4 Other liabilities

The Bank reported among other liabilities the volume of liabilities generated in conjunction with settlements before due date with the amount of HUF 625.4 million; accounts payable of HUF 583.9 million as well as accruals with the volume of HUF 913.5 million. At the end of 2016 volume of provisions stood at HUF 1.5 billion.

7.1.5 Shareholders' equity

FHB Mortgage Bank Co. Plc. at the end of December 2015 increased its share capital with HUF 4,249 billion face value, or HUF 30.5 billion issue value. The capital increase was executed by issuing dematerialized dividend preference shares (Series "B") and dematerialized ordinary shares (Series "C").

On 24 June 2016 the Bank repurchased subordinated Tier 1 capital bond with XS0867086042 ISIN code with a nominal value of EUR 112 million. Among other factors, due to the repurchase within one year, shareholders' equity decreased by 46.9% to HUF 57.6 billion as of 31 December 2016. Balance sheet profit/loss of shareholders of the Bank was HUF 11.0 billion.

7.2 PROFIT & LOSS STRUCTURE

in HUF million	2015 FY	2016 FY	Change
Interest income	41,159	28,742	-30.2%
Interest expense	-26,531	-16,486	-37.9%
Net interest income	**14,628**	**12,256**	**-16.2%**
Fee and commission income	8,591	10,443	21.6%
Fee and commission expense	-1,334	-2,212	65.8%
Net fee and commission income	**7,257**	**8,231**	**13.4%**
Profit/(Loss) from FX transactions	-1,945	329	-
Change in fair value of financial instruments	-2,180	965	-
Gains from securities	3,528	3,034	-14.0%
Net trading result	**-597**	**4,328**	**-**
Other operating income	1,397	2,216	58.6%
Other operating expense	-11,391	-9,205	-19.2%
Net income of associated companies	621	591	-4.8%
Operating income	**11,915**	**18,417**	**54.6%**
Provision for impairment on loan losses	-862	-8,192	-
General and administrative expense	-18,764	-19,545	4.2%
Profit/(Loss) before tax	**-7,711**	**-9,320**	**20.9%**
Income tax benefit/(expense)	-2,838	-6,182	117.8%
Profit/(Loss) for the period	**-10,549**	**-15,502**	**47.0%**

The Bank's consolidated loss for the year by IFRS amounted to HUF 15,502 million in 2016, the consolidated total comprehensive income of the Bank amounted to HUF 15,491 million loss. The negative result is mainly due to the drop of net interest income, and due to other factors: earlier loan losses, predominantly related to retail FX based loans, operating costs, and the one-off deferred tax write-off because of the change of income tax rate. In addition, amount of HUF 1,632 million of special banking tax, HUF 908 million provision set-up for organizational changes and the non-shifted financial transaction levy had negative impact on the result too. The Bank Group's IFRS consolidated profit after tax – ignoring the special banking tax and one-off items – was HUF 2,535 million loss in 2016.

7.2.1 Net interest income

Net interest income was HUF 12.3 billion in 2016, 16.2% lower than a year before. The reason of backwardness are the decreasing loan interests, mainly due to low interest rate environment and mainly due to the limited margin by the "Fair Banking" acts. The net figure emerged as a balance of HUF 28.7 billion interest income (30.2% lower year-on-year) and HUF 16.5 billion interest expense (y/y: -37.9%). The net interest margin to average total assets (NIM) was 1.83% in 2016, 10 bps lower compared to 2015.

Distribution of interest income and expenses shows the following table:

	2015 FY	2016 FY	Change
Interest income			
Loans	46.9%	60.3%	*13.4%-pt*
Refinancing	8.6%	8.0%	*-0.6%-pt*
Mortgage bond interest subsidy	15.4%	14.9%	*-0.4%-pt*
Supplementary interest subsidy	1.3%	1.5%	*0.3%-pt*
Securities and interbank activities	15.1%	14.0%	*-1.1%-pt*
Swap transactions	12.8%	1.2%	*-11.5%-pt*
Interest expenses			
Bonds issued	69.2%	79.2%	*10.0%-pt*
Interbank activities	0.5%	0.7%	*0.2%-pt*
Customer deposits	17.4%	14.4%	*-3.0%-pt*
Derivatives	12.6%	5.8%	*-6.8%-pt*
Other interest expense	0.3%	0.0%	*-0.3%-pt*

7.2.2 Net fees and commissions

In 2016, the Bank achieved a positive balance of HUF 8,231 million from income and expenditures on commissions and fees; 13.4% higher than a year before. Net fees and commissions adjusted by financial transaction levy performed a 15.2% increase year-on-year, respectively.

Compared to the previous year, fee incomes related to mortgage loans increased the most, because over this year the prepayment of refinanced loan portfolio related to AXA Bank has accounted HUF 976 million fee income. Besides bank account and bankcard related fees and fund management fees increased; while guarantee fees decreased. Adjusting one-off fee income and financial transaction levy income, net fees and commissions decreased by 1.8% compared to the previous year.

Income from fees and commissions in 2016 amounted to HUF 10,443 million, of which 20.0% was contributed by charges related to loans and 32.7% by accounts and card related banking charges without financial transaction levy. Volume of HUF 1,613 million of fund management fees contributed by 15.4% to fee income.

Card related fee expenses (HUF 651 million) increased by 30.8% year-on-year, while payment fees reached HUF 209 million in 2016.

7.2.3 Net trading result

In 2016, the balance of financial transactions was HUF 4,328 million profit, which is by HUF 4,925 million higher than a year before. The net result of financial transactions was HUF 329 million in 2016, which is significantly better (by HUF 2,274 million) than it was in 2015. Last year's unfavourable result was due to the foreign exchange loss in customers' loans conversion.

In 2016, the change in the value of financial instruments reported at fair value through P&L was HUF 965 million profit, which is favourable than a year before (HUF 2,180 million loss). The securities transactions resulted in HUF 3,034 million profits as opposed to HUF 3,528 million profits in the previous year.

7.2.4 Other income and expenses

In the year of 2016, the balance of other operating income and expenditure was HUF 7.0 billion net expenditure; arising from HUF 2.2 billion incomes and HUF 9.2 billion expenditures.

In 2016, real estate related income (real estate rent, property management) contributed HUF 213 million to other operating income (real estate rent, management). The Bank group also had HUF 386 million income from card service fees of Hungarian Card Service Plc.

Special banking tax amounted to HUF 1,632 million in 2016, the fees of protection funds, other statutory and voluntary funds, and membership fees of SZHISZ HUF 1,147 million, while paid financial transaction fees HUF 2,280 million.

The Bank has joined to the rationalization project initiated by the Magyar Takarékszövetkezeti Bank Ltd. Due to this the Bank set up HUF 908 million provision for the organizational changes related to the project.

Net income of associated companies contributed HUF 591 million to consolidated figures in 2016, which mainly resulted from three important influencing items of the HUF 245 million (proportional, consolidated) profit of Magyar Takarék Asset Management (MATAK) Ltd. and its investments (of which the proportional result of Takarékbank is HUF 341 million profit), DB Factoring House proportional, HUF 443 million profit and from the HUF 114 million loss (consolidated) realised by Magyar Posta Investment Services Ltd.

7.2.5 Operating expenses

Operating costs amounted to HUF 19.5 billion in 2016 which is 4.2% higher than in 2015. Growth was mainly generated by the increase in personal expenses and in administrative expenses.

Cost-to-income ratio (CIR)[5] was 78.8% in 2016, while 88.1% in 2015.

The contribution of personnel expenses to total operating costs was 40.3% in 2016, 4.73%-points higher than in 2015 (35.6%).

Administrative expenses in 2016 (HUF 9,999 million) increased year-on-year (8.7%). Expenses of business activity altogether slightly decreased year-on-year, HUF 1,092 million expenses in 2016 are 2.4% lower than a year before (HUF 1,118 million).

Other taxes paid reported among operating costs amounted to HUF 96 million in 2016, compared to HUF 56 million in 2015.

7.2.6 Impairment and loan losses

The credit risk costs amounted to HUF 8,192 million in the year of 2016. Beyond the provisioning/releasing impairment for loan losses, the risk cost line is imposed by the results of portfolio cleaning. The impairments amount reduced by 10.2%, HUF 2.7 billion compared to the end of last year.

7.3 CAPITAL POSITION

The consolidated shareholder's equity of FHB Group according to IFRS was HUF 57.6 billion as of 31 December 2016, at the end of 2015 it was HUF 108.5 billion.

FHB Mortgage Bank Co. Plc. at the end of December 2015 increased its share capital with HUF 4,249 billion face value, or HUF 30.5 billion issue value. The Court of Registration approved and registered the capital increase with its resolution on February 24, 2016. Pursuant to the European Regulation CRR valid since 1st of January 2014, the permission of the NBH as the competent authority is required to consider the issued capital instruments as regulatory capital. In case of the shares issued in the capital increase NBH gave permission with its resolution as of March 9, 2016 only to consider the issued 'B' dividend preference shares and 'C' ordinary shares as Tier 1 capital, consequently their total volume will be taken into consideration in the calculation of the regulatory capital after that date.

On 24 June 2016 FHB Mortgage Bank repurchased subordinated Tier 1 capital bond with XS0867086042 ISIN code with a nominal value of EUR 112 million. Due to the transaction own funds of the Bank Group decreased by HUF 31.7 billion.

[5] In the calculation of the ratio, incomes include net interest income, net fee and commission income and net trading result.

Value of the Bank's own funds was HUF 45.6 billion at 31 December 2016. The capital adequacy ratio was 13.71% (one year ago 20.13%). CET1 ratio stood at 12.14% as of 31 December 2016, at the end of 2015 the ratio was 12.54%.

8 POST-BALANCE SHEET DATE EVENTS

The Bank as a result of the discussions started in 2016 has made contracts with 4 new refinancing partners and the first disbursements have made, worth more than HUF 10 billion.

Budapest, 4 April, 2017

József Vida	**Márton Oláh**
Chairman of the Board of Directors	Chief Executive Officer

FHB Jelzálogbank Nyrt.
FHB BANK
1082 Budapest, Üllői út 48.

FHB Mortgage Bank Plc.

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

December 31,2016

FHB Mortgage Bank Public Limited Company

Consolidated Financial Statements in accordance with the International Financial Reporting Standards adopted by the European Union

For the year ended 31 December 2016

Consolidated Financial Statements in Accordance with the International Financial Reporting Standards adopted by the European Union – 31 December 2016

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Chairman of the Board of Directors

József Vida

External Members of the Board of Directors

Gábor Gergő Soltész
Attila Mészáros

Internal Members of the Board of Directors

Márton Oláh
Dr. Erik Landgraf

Chief Executive Officers

Márton Oláh (Chief Executive Officer from 05/12/2016)
Dr. Erik Landgraf (Deputy Chief Executive Officer from 30/11/2016)

Large Shareholders Liaison Officer and Secretary

Rita Bozzai

Small Shareholders Liaison Officer

Béla Kappéter

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INDEPENDENT AUDITOR'S REPORT

To the Shareholders and Board of Directors of FHB Mortgage Bank Plc.

Opinion

We have audited the consolidated financial statements of FHB Mortgage Bank Plc. and its subsidiaries (the „Group") for the year 2016 which comprise the consolidated statement of financial position as at December 31, 2016 – which shows a total assets of HUF 593.404 million –, and the related consolidated statement of recognized income, consolidated statement of comprehensive income – which shows a net loss for the year of HUF 15.502 million –, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and consolidated notes to the financial statements including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the financial position of the FHB Mortgage Bank Plc. and its subsidiaries as at December 31, 2016 and 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 the opinion

We conducted our audit in accordance with the Hungarian National Standards on Auditing and the effective Hungarian laws and other regulations on audits. Our responsibilities under these standards are further described in the „*The auditor's responsibilities for the audit of the consolidated financial statements*" section of our report.

We are independent of the Group in compliance with the Hungarian ethical requirements pertaining to our audit of the consolidated financial statements, and we have fulfilled our other ethical responsibilities in accordance with the same ethical requirements.

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

Key Audit Matters

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

Key audit matter	Related audit procedures
Impairment of the loan receivables	
(See Sections 19 of the Notes to the Consolidated Financial Statements for the details) The net value of loans and advances to customers in an amount of HUF 294,473 million comprise 50% of the total assets (gross book value of HUF 318,326 million), the relevant impairment charge recorded in the current year was HUF 23,853 million. The determination of impairment of loans requires application of professional judgement and use of subjective assumptions by management in case of both the application of portfolio based collective impairment models, and determination of individual specific impairment of loans. The most significant assumptions applied in provisioning calculation are the followings: - valuation of collaterals - probability of default - estimate that future cash-flows expected to be realized. Based on the significance of the above described circumstances the calculation of impairment of loans was identified as a key audit matter.	The relevant audit procedures performed by us included the followings: - evaluate internal controls relating to origination and monitoring of loans, - gained understanding of the Bank 's provisioning process and methodology and parameters used in the calculation of collective impairment losses on loans and receivable in order to evaluate collective impairment - evaluate of specific loan impairments with random sample, including the review of consideration and valuation of collaterals and estimations of expected future cash-flows, - evaluating the underlying assumption of collective provisioning models, - assess the balloon and bullet conditions of corporate loans and the review of consideration these conditions at individual provisioning, - evaluating of appropriateness of related disclosures.

Key audit matter	Related audit procedures
Capital adequacy	
(See Sections 50. of the Notes to the Consolidated Financial Statements for the details) The Equity in consolidated financial statements is HUF 57,602 million. For the purpose of maintaining solvency and the ability to fulfil liabilities - must have a solvency margin complying at all times with the amount of the risk of the financial and investment activities performed thereby, and must continuously maintain at least 8 percent capital adequacy ratio. On balance sheet date the amount of regulatory capital is HUF 45,612 million, the capital adequacy ratio is 13.71%. Accordingly, the capital adequacy is considered to be a key audit matter.	We assessed the solvency capital calculation process, the capital requirement calculation methodology, and we performed regulatory capital recalculation as well. Furthermore with random sample we evaluated the appropriateness of the classification of certain risk exposures and the associated weighting. Regarding credit risk and operating risk we checked the process of capital requirement calculation, and controls applied during the process. With involving of expert we also assessed the appropriate application of the of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013, and disclosures.

Other information

Other information comprises the information included in the "Corporate Governance Report at FHB Mortgage Bank Plc." and the consolidated business report of FHB Mortgage Bank Plc. and its subsidiaries for 2016, but does not include the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information and for the preparation of the consolidated business report in accordance with the relevant provisions of the Act C of 2000 on Accounting (hereinafter: "the Accounting Act") and other regulations. Our opinion on the consolidated financial statements provided in the section of our report entitled "Opinion" does not apply to the other information.

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

Furthermore, in accordance with the Accounting Act, our responsibilities regarding the consolidated business report also include reviewing the consolidated business report to assess whether the consolidated business report was prepared in accordance with the relevant provisions of the Accounting Act and other regulations, if any, including the assessment whether the consolidated business report complies with the requirements of Section 95/B (2) e) and f) of the Accounting Act. Furthermore, in accordance with the Accounting Act we shall make a statement whether the information referred to in Section 95/B (2) a)-d), g) and h) has been provided in the consolidated business report.

In our opinion, the consolidated business report of FHB Mortgage Bank Plc. and its subsidiaries for 2016 corresponds to the consolidated financial statements of FHB Mortgage Bank Plc. and its subsidiaries for 2016 and the consolidated business report was prepared in accordance with the provisions of the Accounting Act. The information referred to in Section 95/B (2) a)-d), g) and h) of the Accounting Act has been provided.

As the Group is not subject to additional requirements under any other regulation in connection with the business report, our opinion on the business report does not include an opinion under Section 156 (5) h) of the Accounting Act.

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

Responsibilities of management and those charged with governance for the consolidated financial statements

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

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

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

The auditor's responsibilities for the audit of the consolidated financial statements

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

As part of an audit in accordance with the Hungarian National Standards on Auditing, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify the opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

Budapest, April 4, 2017

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Tamás Horváth
on behalf of Deloitte Auditing and Consulting Ltd.
and as a statutory registered auditor

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

Registration number of statutory registered auditor: 003449

Consolidated Statement of Profit or Loss for the year ended 31 December 2016

	Notes	2016	2015
Interest income	4	28,742	41,159
Interest expense	4	(16,486)	(26,531)
Net interest income		**12,256**	**14,628**
Fee and commission income	5	10,176	8,352
Fee and commission expense	5	(2,212)	(1,334)
Net fee and commission income		**7,964**	**7,018**
Profit/(loss) from foreign exchange transactions		329	(1,945)
Change in fair value of financial instruments	37	965	(2,180)
Gains from securities		3,034	3,528
Share of profit/(loss) of joint ventures and associates		591	621
Net result from investment services		267	239
Net trading result		**5,186**	**263**
Other operating income	6	2,216	1,397
Other operating expense	7	(9,205)	(11,391)
Operating income, net		**18,417**	**11,915**
Provision for impairment losses on loans	19	(8,192)	(862)
General and administrative expenses	8	(19,545)	(18,764)
Loss before tax		**(9,320)**	**(7,711)**
Income tax benefit/(expense)	11	(6,182)	(2,838)
Loss for the year		**(15,502)**	**(10,549)**
Attributable to: loss of shareholders of the Bank		(11,048)	(8,304)
Attributable to: non-controlling interests		(4,454)	(2,245)
Earnings per share (HUF 100 face value)	33		
Basic earnings per share (HUF)		**(102.07)**	**(126.31)**
Diluted earnings per share (HUF)		**(102.07)**	**(126.31)**

All figures in tables are in HUF million except otherwise noted

The Notes comprising a summary of significant accounting policies and other explanatory information form an integral part of the Financial Statements

Consolidated Statement of Other Comprehensive Income for the year ended 31 December 2016

	Notes	2016	2015
Loss for the year		(15,502)	(10,549)
Other comprehensive income			
Items that may be reclassified to profit or loss:			
Change in fair value of financial assets available-for-sale		30	699
Foreign currency translation reserve		(18)	-
Deferred tax effect for other comprehensive income		(1)	(133)
Other comprehensive income/(loss) for the period net of taxes	12	11	566
Total comprehensive income for the year, net of income taxes		**(15,491)**	**(9,983)**
Attributable to: loss of shareholders of the Bank		(11,037)	(7,738)
Attributable to: non-controlling interests		(4,454)	(2,245)

All figures in tables are in HUF million except otherwise noted

Consolidated Statement of Financial Position as at 31 December 2016

	Notes	31 December 2016	31 December 2015
Assets			
Cash on hand		4,327	3,017
Balances with the National Bank of Hungary	13	60,635	162,749
Due from banks	14	70,289	48,208
Securities held for trading	15	40,734	51,913
Financial assets available-for-sale	16	66,295	74,042
Shares in associates and joint ventures	29	4,816	7,755
Derivative financial assets	37	933	884
Refinanced mortgage loans	18	31,423	82,790
Loans and advances to customers	19	294,473	288,298
Investment property	21	780	780
Tangible assets	22	4,942	6,168
Goodwill and other intangible assets	20,23	2,042	1,915
Deferred tax asset	11	3,030	8,232
Other assets	24	8,685	8,069
Total assets		**593,404**	**744,820**

All figures in tables are in HUF million except otherwise noted

Consolidated Statement of Financial Position as at 31 December 2016

	Notes	31 December 2016	31 December 2015
Liabilities			
Due to banks	25	47,229	39,774
Deposits from customers	28	297,072	329,048
Derivative financial liabilities	37	1,579	2,308
Issued securities	26	170,283	235,115
Financial liabilities at fair value through profit or loss, except for derivatives	27	11,991	19,878
Finance lease liabilities	30	3	12
Current tax liability		-	1
Deferred tax liability	11	-	1
Provisions	31	1,546	999
Other liabilities	32	6,099	9,152
Total liabilities		**535,802**	**636,288**
Shareholders' equity			
Share capital	33	10,849	10,849
Treasury shares	33	(207)	(207)
Retained earnings		1,613	16,137
Other reserve	33	28,535	60,273
Non-controlling interest	33	16,812	21,480
Total shareholders' equity		**57,602**	**108,532**
Total liabilities and shareholders' equity		**593,404**	**744,820**

Budapest, 4 April 2017

Márton Oláh
CEO

FHB Jelzálogbank Nyrt. FHB BANK 1082 Budapest, Üllői út 48.

dr. Landgraf

Dr. Erik Landgraf
Deputy CEO

All figures in tables are in HUF million except otherwise noted

Consolidated Statement of Cash Flows for the year ended 31 December 2016

	2016	2015
Cash flow from operating activities		
Loss for the year	(15,502)	(10,549)
Non-cash adjustments to net loss from:		
Depreciation and amortization (Note 22,23)	475	1,710
Impairment of tangible assets	1,100	-
(Release)/provision of provision for losses	(569)	(34,104)
Gain/ (loss) on tangible assets derecognized	(7)	74
Gain/ (loss) on intangible assets derecognized	45	(170)
Capitalized interest on loans and advanced to customers	317	750
Fair value adjustment of derivatives (Note 37)	(778)	(8,765)
Fair value adjustment on financial liabilities through profit or loss, except derivatives	(987)	(1,494)
Change in foreign currency translation reserve	(16)	-
Change in investment in associates	2,939	(823)
Finance lease liabilities	(9)	-
Operating loss before change in operating assets	**(12,992)**	**(53,371)**
Decrease/(Increase) in operating assets:		
Securities held for trading	11,179	(17,317)
Financial assets available-for-sale	7,773	1,901
Refinanced mortgage loans	51,367	33,392
Loans and advances to customers	(5,376)	39,954
Other assets	4,586	3,312
Increase/(Decrease) in operating liabilities:		
Deposits from customers	(31,976)	30,286
Due to banks	(85,290)	(30,719)
Other liabilities	(3,053)	5,114
Net cash flow from operating activities	**(63,782)**	**12,552**

All figures in tables are in HUF million except otherwise noted

The Notes comprising a summary of significant accounting policies and other explanatory information form an integral part of the Financial Statements

Consolidated Statement of Cash Flows for the year ended 31 December 2016 - continued

	2016	2015
Cash flow from investing activities		
Proceeds from sales of tangible assets	35	1,189
Purchase of tangible and intangible assets	(549)	(640)
Purchase of investment property	-	(780)
Net cash outflow from investing activities	**(514)**	**(231)**
Cash flow from financing activities		
Proceed from issued securities	39,248	77,992
Principal repayment on issued securities	(110 981)	(113 349)
Repayment of long term loans	92,745	27,457
Long term loan borrowings	-	-
Finance lease liabilities	-	(949)
Change in non-controlling interests		8
Dividend payment to non-controlling interests	(214)	-
Issue of Capital Securities	-	30 466
Repayment of Capital Securities (additional tier1 capital)	(35,225)	-
Net cash outflow from financing activity	**(14,427)**	**21,625**
Net (decrease)/increase in cash and cash equivalents	(78,723)	33,946
Opening balance of cash and cash equivalents	213,974	180,028
Closing balance of cash and cash equivalents	**135,251**	**213,974**
Breakdown of cash and cash equivalents:		
Cash on hand	4,327	3,017
Balances with the National Bank of Hungary	60,635	162,749
Due from banks with a maturity of less than 90 days	70,289	48,208
Closing balance of cash and cash equivalents	**135,251**	**213,974**
Supplementary data		
Income tax paid	*(1,478)*	*(2,045)*
Interest received	*29,276*	*47,669*
Interest paid	*(19,384)*	*(32,529)*

All figures in tables are in HUF million except otherwise noted

Consolidated Statement of Changes in Equity for the year ended 31 December 2016

	Notes	Share capital	Treasury shares	Share premium	Share option reserve	Additional tier 1 capital	Change in fair value of fin. assets available-for-sale	Foreign currency translation reserve	Retained earnings	Non-controlling interest	Share-holder's equity
1 January 2015		**6,600**	**(207)**	**1,709**	**-**	**31,749**	**18**	**14**	**24,448**	**23,717**	**88,048**
Capital increase		4,249		26,217							30,466
Loss for the year									(8,304)	(2,245)	(10,549)
Other comprehensive income	12						566				566
Change in non-controlling interests									(7)	49	42
Dividend payment to NCI										(41)	(41)
1 January 2016		**10,849**	**(207)**	**27,926**	**-**	**31,749**	**584**	**14**	**16,137**	**21,480**	**108,532**
Loss for the year									(11,048)	(4,454)	(15,502)
Other comprehensive income	12						27	(16)			11
Settlement of additional tier 1 capital						(31,749)			(3,476)		(35,225)
Change in non-controlling interests											-
Dividend payment to NCI										(214)	(214)
31 December 2016		**10,849**	**(207)**	**27,926**	**-**	**-**	**611**	**(2)**	**1,613**	**16,812**	**57,602**

All figures in tables are in HUF million except otherwise noted

1. DESCRIPTION OF THE BANK

FHB Mortgage Bank Public Limited Company ("FHB" or "the Bank") was established by the Hungarian State on 21 October 1997 as a limited liability company with a share capital of HUF 3 billion.
The Bank provided mortgage-banking services through its Head Office and regional representative offices located within the Republic of Hungary. The Bank also refinances mortgage loans provided by commercial banks to their customers.

The Bank received its license on 6 March 1998 to operate as a specialized financial institution in accordance with the provisions of Act CXII of 1996 on Credit Institutions and Financial Enterprises and Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds. The Bank commenced operations as of 16 March 1998.

On 31 October 2003 the Hungarian Financial Supervisory Authority (HFSA) granted permission for FHB Mortgage Bank to issue a prospectus to introduce its shares to the Budapest Stock Exchange. The ordinary shares were listed on the Budapest Stock Exchange on 24 November 2003.

FHB Mortgage Bank Co. Plc. at the end of December 2015 increased its share capital with HUF 4,249 billion face value, or HUF 30.5 billion issue value. Capital increase was executed by issuing dematerialized dividend preference shares (Series "B") and registered, dematerialized ordinary shares (Series "C"). The new shares (Series "B" and Series "C") were no listed on the Budapest Stock Exchange.

The Bank introduced its New Strategic Plan in February 2006 to expand its banking activity and branch network. The Bank set up new subsidiaries, among them the FHB Commercial Bank Ltd., thereby significantly expanding the range of services provided by FHB Group. FHB Mortgage Bank Plc. is the parent company of the group. (The Bank and its subsidiaries are jointly referred to as the Group, Bank Group or FHB Group.)

The Strategic Plan for the business years 2013-2015 was adopted by the Board of Directors of FHB Mortgage Bank in 2012. The new strategy was built on the results achieved with the previous plans, the possible advantages from the strategic partnership with Allianz and the commitment of the employees of the Group, defining clear targets for the development of the Group. FHB would like to become a customer- and service-driven medium bank based on the previously adopted conception of "The bank of the families" providing customer based service supported by an organisational culture where the achievement of the common goals is reached with the strong co-operation of the employees.

In 2013, FHB Mortgage Bank managed several acquisitions, there through broadened the Banking Group and the range of activities.

The Bank signed a contract in July 2013 to buy 99,9% of ordinary shares of the Diófa Alapkezelő Zrt. (Diófa Fund Management Ltd.). The specified contractual conditions required for the effective transfer of the shares were satisfied by the parties on 2 September 2013, so 100% of ordinary shares of Diófa Asset Management went to the ownership of FHB Mortgage Bank.

As a result of several months of negotiations, FHB has signed first a letter of intent, and then on 10 July 2013, a purchase agreement with the shareholders of Díjbeszedő Holding Ltd. ("DBH"), to the business shares of FHB Invest Ltd. (former Díjbeszedő Operational and Service Limited Liability Company; hereinafter the "DÜSZ") that come into being after a demerge from DBH. In course of the demerge DÜSZ owns 51% of the shares of Díjbeszedő Faktorház Co. Plc. (“DBF”), 75% of the shares of DíjNET Ltd. and 50% of the shares of Díjbeszedő Informatikai Lld (“DBIT”).

Related to the transaction of the business shares, FHB and the Magyar Posta (Hungarian Post) entered into a strategic cooperation, and in the scope of that they shall cooperate in the ownership and control of FHB Invest Ltd. (former DÜSZ), DBH and the jointly controlled companies, furthermore in course of the harmonization of the business activities of FHB Invest and the members of the DBH Group.

Based on the Agreement between FHB Group and Magyar Posta, FHB Invest acquired 50% of shares of Magyar Posta Befektetési Zrt. (Hungarian Post Investment Services Ltd., hereinafter the “MPBSZ Ltd.”).

According to the strategic cooperation between FHB Group and Magyar Posta, the DBFA, DíjNET, DBIT and MPBSZ Ltd. are jointly controlled companies by direct control of FHB Invest Ltd., which means 50% of influence of jointly controlled companies, independently of proportion of ownership interests. On 24 January 2014, the National Bank of Hungary gave the necessary permission, FHB Invest Ltd, DBF and the MPBSZ Ltd. are under prudential supervisory.

At the beginning of 2014 FHB Mortgage Bank Plc. acquired 25% shares in Magyar Takarék Asset Management Ltd. by capital increase, through which FHB Mortgage Bank obtained 13,76% indirect qualifying holding in Bank of Hungarian Savings Cooperatives Co. Ltd. after the permission of National Bank of Hungary.

Based on the Act CXXXV of 2013 on integration of cooperative financial institiutions and modification of certain rules on economic issues (Szhitv), FHB Mortgage Bank Plc. and under its qualifying holding and prudential supervisory FHB Commercial Bank Ltd. became a member of Integration Organisation of Cooperative Credit Institution (SZHISZ) on 23 September 2015.

From 24 September 2015 the joint and several responsibilities defined in the Section 4 of Article 1 of Szhitv cover also Mortgage Bank and Commercial Bank, according to the decision of the Board of Directors of Takarékbank Ltd.

As parent company of FHB Group, the Mortgage Bank exercises its rights over the Group companies.

The consolidated financial statements for the year ended 31 December 2016 were authorized for issue in accordance with a resolution of the Board of Directors on 4 April 2017. The final approval on the consolidated financial statements is provided by the General Meeting.

2. ACCOUNTING POLICIES

2. 1. *Basis of preparation*

The consolidated financial statements have been prepared on a historical cost basis, except for financial investments available-for-sale and held for trading, investment property, derivative financial instruments and financial liabilities measured at fair value through profit or loss, that have been measured at fair value.

Statement of compliance

The consolidated financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU).

2. 2. *Change in accounting policies*

The effect of adopting new and revised International Financial Reporting Standards effective from 1 January 2016

The following standards, amendments to the existing standards and interpretations issued by the IASB and adopted by the EU are effective for the current period:

- **Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 12 "Disclosure of Interests in Other Entities" and IAS 28 "Investments in Associates and Joint Ventures"** – Investment Entities: Applying the Consolidation Exception – adopted by the EU on 22 September 2016 (effective for annual periods beginning on or after 1 January 2016).
- **Amendments to IFRS 11 "Joint Arrangements"** – Accounting for Acquisitions of Interests in Joint Operations – adopted by the EU on 24 November 2015 (effective for annual periods beginning on or after 1 January 2016).
- **Amendments to IAS 1 "Presentation of Financial Statements"** – Disclosure Initiative – adopted by the EU on 18 December 2015 (effective for annual periods beginning on or after 1 January 2016),
- **Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets"** – Clarification of Acceptable Methods of Depreciation and Amortisation – adopted by the EU on 2 December 2015 (effective for annual periods beginning on or after 1 January 2016),
- **Amendments to IAS 16 "Property, Plant and Equipment" and IAS 41 "Agriculture"** – Bearer Plants – adopted by the EU on 23 November 2015 (effective for annual periods beginning on or after 1 January 2016),
- **Amendments to IAS 19 "Employee Benefits"** – Defined Benefit Plans: Employee Contributions – adopted by the EU on 17 December 2014 (effective for annual periods beginning on or after 1 February 2015),
- **Amendments to IAS 27 "Separate Financial Statements"** – Equity Method in Separate Financial Statements – adopted by the EU on 18 December 2015 (effective for annual periods beginning on or after 1 January 2016).
- **Amendments to various standards "Improvements to IFRSs (cycle 2010-2012)"** resulting from the annual improvement project of IFRS (IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 17 December 2014 (amendments are to be applied for annual periods beginning on or after 1 February 2015),
- **Amendments to various standards "Improvements to IFRSs (cycle 2012-2014)"** resulting from the annual improvement project of IFRS (IFRS 5, IFRS 7, IAS 19 and IAS 34) primarily with a view to removing inconsistencies and clarifying wording - adopted by the EU on 15 December 2015 (amendments are to be applied for annual periods beginning on or after 1 January 2016).

The adoption of these amendments to the existing standards and interpretation has not led to any material changes in the Group's Consolidated Financial Statements.

New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective

At the date of authorisation of these financial statements the following standards, amendments to the existing standards and interpretations issued by IASB and adopted by the EU were in issue but not yet effective:

- **IFRS 9 "Financial Instruments"** – adopted by the EU on 22 November 2016 (effective for annual periods beginning on or after 1 January 2018),
- **IFRS 15 "Revenue from Contracts with Customers"** and amendments to IFRS 15 "Effective date of IFRS 15" – adopted by the EU on 22 September 2016 (effective for annual periods beginning on or after 1 January 2018).

The application of IFRS 15 might have no significant impact on the group financial statement.

The Bank Group has been preparing for the transition to IFRS 9 since 2016, whereby those subject matters has been identified which may cause significant differences compared to the approach of IAS 39. These subject matters are the following: classification of financial assets, business model tests, modelling techniques for impairment based on expected credit losses, and for incorporating forward-looking information, the evaluation of financial assets on which the credit risk has increased significantly since initial recognition, and the approach to hedge accounting. The scheduling of IFRS 9 transition and adequate test runs facilitate the Bank Group to be able switch to IFRS based bookkeeping on 01. January 2018 and be able to provide high quality IFRS 9 information after the transition.

Classification of financial assets and business models

The Bank Group will apply the exemption provided by IFRS 9 Chapter 7 which allows to accomplishing SPPI and business model test with the consideration of facts and circumstances that exist at the date of transition, therefore on 01. January 2018. With the involvement of consultants the Bank Group preliminary reviewed the classification requirements of IFRS 9 related to SPPI and business model tests. As a combined result of these tests, examined to which category should the financial assets be classified. The Bank Group performed this analysis for those financial assets which are not anticipated to be derecognised until the IFRS 9 transition. The whole portfolio was divided to homogenous parts along to relevant classification requirements of IFRS 9 to enhance the efficiency of the analysis. Based on the facts and circumstances existed on the date of analysis the Bank Group divided its portfolio and examined which business model is prevailing for different sub portfolios. As a result of the preliminary classification analysis the Bank Group gained a comprehensive view from those financial instruments which are differently treated under IFRS 9 than under IAS 39.

Modelling techniques for impairment based on expected credit losses, and for incorporating forward-looking information

The Bank Group preliminary reviewed the IFRS 9 specific requirements for impairment and the main differences compared to IAS 39. The aim of the Bank Group is to use all reasonable and acceptable information which is relevant for individually and collectively measured exposures and essential for performing IFRS 9 implementation reasonably and consistently. The Bank Group performed those segmentations on existing portfolio which facilitate the application of impairment requirements, and specified those risk management related definitions which are not exhaustively defined under IFRS. The Bank Group has planned the changes of methodology for individual and collective loss allowances and the implementation of expected credit loss model. The forward-looking information has an important role in the process of evolving impairment models. The Bank Group is examining the feasibility of implementation of multi-scenario impairment methodology required by IFRS 9. The Bank Group examined the IFRS 9 staging requirements and determined those indicators which facilitate to assess whether credit risk has increased significantly since initial recognition or whether the financial asset becomes credit impaired.

The approach to hedge accounting

The Bank Group compared the hedge accounting related requirements of IFRS 9 to actually applied IAS 39 requirements. As a result of the comparison, the Bank Group assessed the opportunities and difficulties provided by each standards. The Bank Group currently examines the following opportunities provided by IFRS 9, and as a result of the examination a decision will be made whether to switch to IFRS 9:

- hedging of group of items
- portfolio hedge / macro hedging
- hedge of components
- rebalancing
- new potential methodology of hedge effectiveness measurement

New methodology prohibits the voluntary discontinuation of hedge accounting when the risk management objective for a particular hedging relationship remains the same and all the other qualifying criteria are still met.

Based on the aforementioned description, the IFRS 9 implementation is being accomplished as scheduled by work team set up by Bank Group during 2016, where both accounting and risk management delegated experts engage in.

Standards and Interpretations issued by IASB, but not yet adopted by the EU

- **IFRS 14 "Regulatory Deferral Accounts"** (effective for annual periods beginning on or after 1 January 2016) – the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- **IFRS 16 "Leases"** (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to IFRS 2 "Share-based payment**" – Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018).
- **Amendments to IFRS 4 "Insurance contracts**" – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (effective for annual periods beginning on or after 1 January 2018, or when IFRS 9 "Financial Instruments" is applied first time).
- **Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures"** – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date was deferred indefinitely until the research project on the equity method has been concluded),
- **Amendments to IFRS 15 "Revenue from Contracts with Customers"** – Clarifications to IFRS 15 Revenue from Contracts with Customers (effective for annual periods beginning on or after 1 January 2018),
- **Amendments to IAS 7 "Statement of Cash Flows"** – Disclosure Initiative (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IAS 12 "Income Taxes"** – Recognition of Deferred Tax Assets for Unrealised Losses (effective for annual periods beginning on or after 1 January 2017).
- **Amendments to IAS 40 "Investment property"** – Transfers of Investment Property (issued on 8 December 2016, effective for annual periods beginning on or after 1 January 2018).
- **Amendments to various standards "Improvements to IFRSs (cycle 2014-2016)"** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017 and amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),
- **IFRIC Interpretation 22 "Foreign Currency Transactions and Advance Consideration** (effective for annual periods beginning on or after 1 January 2018).

The Group anticipates that the adoption of these standards, amendments to the existing standards and interpretations will have no material impact on the Consolidated Financial Statements of the Group in the period of initial application.
Hedge accounting for a portfolio of financial assets and liabilities, whose principles have not been adopted by the EU remains unregulated.
According to the Group`s estimates, application of hedge accounting for the portfolio of financial assets or liabilities pursuant to IAS 39: "Financial Instruments: Recognition and Measurement", would not significantly impact the Consolidated Financial Statements, if applied as at the end of the reporting period.

2.3 Currency of the consolidated financial statements

Unless otherwise stated, the consolidated financial statements are presented in million of Hungarian forint (HUF), the Hungarian forint is the functional and presentation currency used by Bank and each of its subsidiaries with registered office in Hungary. The functional currency of the Croatian company belonging to the Bank is the Croatian kuna (HRK). The functional currency of the German branch of FHB Commercial Bank Ltd. is the Euro (EUR).

2.4 Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Bank and all its subsidiaries as at 31 December 2016.

Control is presumed to exist where the Bank holds, directly or indirectly, more than 50% of the registered capital or where the Bank can exercise more than 50% of the voting rights or where the Bank can appoint or dismiss the majority of the members of the Board of Directors.

Consolidation involves all of the subsidiaries as of the day of acquisition of control. Consolidation of the subsidiaries ceases when the Company loses control of the subsidiaries. Control achieved when the Bank has power over the investee, is exposed, or has rights, to variable returns from its involvement with investee, and has the ability to use its power to affect its return.

The effects of all material intercompany balances and transactions are eliminated. In 2016 the Bank had eleven (including the branch) directly or indirectly owned subsidiaries, nine of them registered in Hungary and one branch in Germany (FHB Commercial Bank Ltd. Niederlassung Frankfurt). The FHB Group acquired the DÜSZ Group and the Diófa Alapkezelő Ltd. and founded the FHB Kártyaközpont Ltd. in 2013. The expanding of FHB Group continued in 2014 with the Magyar Takarék Befektetési és Vagyongazdálkodási Ltd., the associated company, and its subsidiary Magyar Takarékszövetkezeti Bank Ltd. (Bank of Hungarian Saving Cooperatives, ”MTB”). MTB has 3 subsidiaries and 62 controlled companies (controlled by MTB and Integration of Savings Cooperatives). The joint ventured companies and associates are consolidated using the equity method. According to the strategic cooperation in case of the jointly controlled companies there is 50% of influence, independently of proportion of ownership interests.

The list of the subsidiaries, joint ventures (joint control with Hungarian Post Ltd.) and associates of the Bank as at 31 December 2016 is the following:

Companies included in the consolidation	Main shareholder***	Core business	Relation-ship *
FHB Commercial Bank Ltd.	FHB Mortgage Bank Plc. 51%	Universal banking services	S
FHB Real Estate Ltd.	FHB Mortgage Bank Plc. 100%	Real estate valuation services, real estate agency and sales	S
FHB INVEST Befektetési és Ingatlankezelő Ltd.	FHB Mortgage Bank Plc. 100%	Own property management, leasing, and operating , facility management	S
Diófa Alapkezelő Ltd.	FHB Mortgage Bank Plc. 89.19%	Fund and property management	S
Magyar Kártya Szolgáltató Ltd.	FHB Commercial Bank Ltd. 99.18%	Providing services related to bank cards, and electronic payment systems	S
FHB Lízing Ltd.	FHB INVEST Befektetési és Ingatlankezelő Ltd. 100%	Lending and leasing	S
Central European Credit d.d. (Croatia)	FHB Lízing Ltd. 100%	Lending	S
FHB DWH Ltd.	FHB Lízing Ltd. 100%	Data processing and web-hosting	S
Diófa Ingatlankezelő Ltd.	Diófa Alapkezelő Ltd. Ltd. 100%	Real estate management	S
Kary-villa Real Estate Investment Ltd.	FHB Real Estate Ltd. 100%	Sale of own properties	S
Díjbeszedő Faktorház Ltd.	FHB INVEST Befektetési és Ingatlankezelő Ltd. 51%	Purchasing, handling and collection receivables of retail customers	JV
Díjbeszedő Informatikai Ltd.	FHB INVEST Befektetési és Ingatlankezelő Ltd. 50%, Díjbeszedő Holding Ltd. 50 %	Providing IT services primarily to the members of Díjbeszedő Group	JV
Magyar Posta Kártyaközpont Ltd.	Díjbeszedő Holding Ltd. 50,05%	Providing services related to bank cards, and electronic payment systems	JV
DÍJNET Ltd.	FHB INVEST Befektetési és Ingatlankezelő Ltd. 51%	Providing electronic bill payment services	JV

All figures in tables are in HUF million except otherwise noted

Notes to the Consolidated Financial Statements

Companies included in the consolidation	Main shareholder***	Core business	Relation-ship *
Magyar Posta Befektetési Szolgáltató Ltd.	FHB INVEST Befektetési és Ingatlankezelő Ltd. 50%, Magyar Posta Ltd. 50%	Selling investment products	JV
Magyar Takarék Befektetési és Vagyongazdálkodási Ltd.	FHB Mortgage Bank Plc. 25,099%	Property and real estate management	A
Magyar Takarékszövetkezeti Bank Ltd.	Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. 54,82%	Credit institution, the central bank of the integration of Savings Cooperatives	A
Takarék Faktorház Ltd.	Magyar Takarék-szövetkezeti Bank Ltd. 100%	Providing full factoring services	A
Takarékszövetkezeti Informatikai Ltd.	Magyar Takarék-szövetkezeti Bank Ltd. 52,38% SZHISZ** 47,62%	The leading IT service provider of the integration of Savings Cooperatives – as outsourced activity – primarily provides IT system operation and system integration services in the field of banking IT	A
Banküzlet Vagyonkezelő és Hasznosító Ltd.	Magyar Takarék-szövetkezeti Bank Ltd. 48,99% Saving Cooperatives shares 29,92% SZHISZ** 29.01%	Debt collection, debt recovery, intermediation of financial services	A
MTB Ingatlan Ltd.	Magyar Takarék-szövetkezeti Bank Ltd. 100%	Sale of properties	A
MA-TAK-EL Magyar Takarék Ellátó Ltd.	FHB INVEST Befektetési és Ingatlankezelő Ltd. 40%, Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. 40%	Providing bank security, facility management and other operating services excluding IT services	A
Finity Ltd.	MA-TAK-EL Magyar Takarék Ellátó Ltd. 100%	business / other management consulting services	A

***** “SZHISZ” = Integration of Savings Cooperatives***

****** % in the column = the ownership of the main shareholder***

All figures in tables are in HUF million except otherwise noted

Joint ventures according to the strategic cooperation with Hungarian Post Ltd., without the ownership of FHB:

Companies included in the consolidation	Main shareholder	Core business	Relation-ship *
EPDB Nyomtatási Központ Ltd.	Díjbeszedő Holding Ltd. 100%	Supplying post production and printing	JV
Díjbeszedő Holding Ltd.	Magyar Posta Ltd. 100%	Providing fee collection, bill delivery, purchasing receivables, printing and IT development services related to the billing for utilities, banking and telecommunication sector players with large retail customer base	JV

Relationship: "S"=subsidiary, "JV"= joint venture;"A"=associate

Controlled companies of MTB and Integration of Savings Cooperatives (SZHISZ), without the ownership of FHB, where MTB and SZHISZ have significant influence:

Companies included in the consolidation	Shareholder	Core business
3A Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
AGRIA Bélapátfalva Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
AZÚR TAKARÉK Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
B3 TAKARÉK Szövetkezet	owners outside the scope of consolidation	Savings Cooperative
Bácska Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Boldva és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Bóly és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Borotai Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
BORSOD TAKARÉK Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Bükkalja Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
CENTRÁL TAKARÉK Szövetkezet	owners outside the scope of consolidation	Savings Cooperative
Dunaföldvár és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Dunakanyar Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Eger és Környéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Endrőd és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Észak Tolna Megyei Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Fegyvernek és Vidéke Körzeti Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative

Companies included in the consolidation	Shareholder	Core business
Felsőzsolca és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Fókusz Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Főnix Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Füzes Takarék Szövetkezeti Hitelintézet	owners outside the scope of consolidation	Savings Cooperative
Gádoros és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Gyulai Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Hajdú Takarék Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Hajós és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Hungária Takarék Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Jászárokszállás és Vidéke Körzeti Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Kelet Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Kevermes és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Kinizsi Bank Ltd.	owners outside the scope of consolidation	Savings Cooperative
Kis-Rába menti Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Kondorosi Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Lövő és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
M7 Takarék Szövetkezet	owners outside the scope of consolidation	Savings Cooperative
Mátra Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
MECSEK TAKARÉK Szövetkezet	owners outside the scope of consolidation	Savings Cooperative
Mohácsi Takarék Bank Ltd.	owners outside the scope of consolidation	Savings Cooperative

Companies included in the consolidation	Shareholder	Core business
Nyírbélteki Körzeti Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Örkényi Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Pannon Takarék Bank Ltd.	owners outside the scope of consolidation	Savings Cooperative
Pannonhalma és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Pátria Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Pilisvörösvár és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Pillér Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Rábaközi Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Rajka és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Rónasági Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Sajóvölgye Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
SAVARIA Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szabadszállás és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szabolcs Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szarvas és Vidéke Körzeti Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szeghalom és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szegvár és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szendrő és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szentlőrinc-Ormánság Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szerencs és Környéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Szigetvári Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Téti Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Újszász és Vidéke Körzeti Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Zala Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative
Zomba és Vidéke Takarékszövetkezet	owners outside the scope of consolidation	Savings Cooperative

2.5 Rounding

When rounding to thousands, anything above the midpoint of HUF 500 is rounded up and anything below and including the midpoint is rounded down. When rounding to millions, anything above the midpoint of HUF 500,000 is rounded up and anything below and including the midpoint is rounded down.

2.6 Summary of significant accounting policies

a) Categories of financial instruments

The Bank groups the recognised financial assets as follows:

- Cash and cash equivalents

- Financial assets at fair value through profit or loss:
  - Securities held for trading
  - Derivatives classified as held for trading
  - Financial assets designated at fair value through profit or loss

- Loans and receivables:
  - Balances with the National Bank of Hungary
  - Due from banks
  - Refinanced mortgage loans
  - Loans and advances to customers
  - Finance lease receivables

- Financial assets available-for-sale

The Bank groups the recognised financial liabilities as follows:

- Financial liability instruments at fair value through profit or loss:
  - Derivatives
  - Financial liabilities designated at fair value through profit or loss

- Financial liabilities measured at amortised cost (other financial liabilities):
  - Due to banks
  - Customer deposits
  - Government loans
  - Issued bonds
  - Finance lease liabilities

b) Cash and cash equivalents

For the purpose of the Consolidated Statement of Cash Flows, cash and cash equivalents include cash at hand, receivables from the National Bank of Hungary, and receivables from banks with an original maturity of not more than 90 days.

c) *Securities held for trading*

Financial assets held for trading are recorded in the statement of financial position at fair value. Changes in fair value are recognised in 'Net trading income'. Interest and dividend income or expense is recorded in 'Net trading income' according to the terms of the contract, or when the right to the payment has been established.

Included in this classification are debt securities and loans to customers that have been acquired principally for the purpose of selling or repurchasing in the near term depending on the market price.

d) *Financial assets available-for-sale*

The Bank reports the debt securities as available-for-sale that are not purchased for a pre-determined period as it does not intend to trade them nor hold them until maturity but may sell them any time depending on the market, with a view to improving liquidity.

The Bank measures financial assets available-for-sale at fair value. In cases where the market value is not available the fair value of securities is reported as the discounted present value of estimated future cash payments. In cases where the unrealised gains and losses resulting from remeasurement are reported in equity in the other comprehensive income item.

At each balance sheet date the Bank assesses whether there is objective evidence that a financial asset available-for-sale is impaired. If the impairment test shows a potential significant loss or that is expected to prevail over a long term, the Bank derecognizes loss from the other comprehensive income and reports it directly in the statement of profit or loss. If the market value of financial assets available-for-sale recovers in the coming years, the impairment will be reversed, depending on the type of instrument (in profit or loss or in other comprehensive income depending on whether it is debt or equity instruments).

Interest on financial assets available-for-sale is determined by using the effective interest rate method (see in detail later 2.6 dd)). Changes in the carrying amount of available-for-sale monetary financial assets relating to foreign currency rates, interest income calculated using the effective interest method and dividends on available-for-sale equity instruments are recognised in consolidated statement of profit or loss. Derecognition of financial assets available-for-sale is based on the FIFO method.

e) *Refinanced mortgage loans*

The Bank has a substantial refinanced mortgage loans portfolio. As part of the refinancing arrangements, partner banks sell independent and separated liens (which are used as collateral for housing loans) to the Bank. The independent and separated lien is then sold back to the partner banks such way that the repurchase of the independent lien is scheduled to mirror the principal repayment schedule of the particular mortgage loan of the partner bank's customer. The instalment from the partner banks is due irrespective of whether or not the partner bank receives repayments from its customer.

The individual mortgage loans of the partner banks' customers that are refinanced are in conformity with the relevant statutory requirements (being that these loans are performing). The classification is made, impairment is reported and receivables from the clients is reported for these individual loans by the partner banks. Refinanced mortgage loans are classified as performing because by purchasing the independent and separated lien the Bank gives a long-term loan to the partner commercial bank and the client risk is entirely borne by the partner banks, the risk the Bank bear is the credit risk of the partner banks.

Refinanced mortgage loans are presented at amortized cost less impairment losses (if any).

f) Loans and advances to customers

Loans provided directly to customers are reported as loans and advances to customers and are measured at amortized cost less any impairment losses. If there is objective evidence that an impairment loss has been incurred, the carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of profit or loss.
All loans and advances are recognized upon their disbursement.

g) Restructuring of loans

In cases of serious default the Bank favours renegotiating the loans to customers instead of foreclosure wherever possible. Renegotiated loans may be restructured by extending of the loan term and/or agreeing on new conditions. The Group doesn't measure any significant gain or losses on the restructuring loans.

The Bank management keeps track of renegotiated loans to ensure all terms and conditions are met and to secure future cash payments. Provision for impairment of restructured loans is set up on an individual as well as on a portfolio basis and with the application of the original effective interest rate of the loan.
Most of the lease contracts are restructured loans and therefore the provision is set up the same way as at a restructured loan. In case of renegotiated loans the classification of the clients (and eventually the provision) may improve if the clients start to pay their instalments as scheduled. The new buffer account scheme and the converted HUF loans (under the new State program, see note 2.9) were dealt with the same process like other refinanced mortgage loans in spite of the originated loan has not got any payment problem.

h) Impairment losses on loans

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

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default of delinquency in interest or principal payments and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Impairment on a particular loan or a group of similar loans is recognized if their book value is greater than the estimated recoverable amount. The recoverable amount is the present value of expected future cash flows, including amounts recoverable from guarantees and collaterals, discounted based on the loan's original effective interest rate. The impairment for significant loans is assessed individually. For those loans that are of insignificant in their individual amounts the Bank assesses impairment on a portfolio basis, taking into consideration the type and the classification of the loan, non-performance history and losses.
The Bank writes off loss on loans and advances when borrowers are unable to fulfil their obligations to the Bank and when relevant evidence has been obtained through the appropriate legal proceedings.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of profit or loss. The impairment of loans and advances are recognized as credit loss expenses. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to the 'Credit loss expense'.

The Group applies individual evaluation for receivables from non-retail customers, reverse mortgage transactions and certain receivables of FHB Lízing Ltd.

In the course of individual evaluation the credit rating department and decisive management evaluate wholly all observable information during definition of rating classes and amount of impairment, mainly amount of receivables, default, foreclosures, debtor's payment discipline, attitude, etc.

The Group applies collective and statistical evaluation in cases of covered receivables from retail customers and overdraft receivables from retail customers.

The Group applies collective and simplified evaluation in cases of uncovered receivables except of overdraft receivables.

i) Leases

Determination of whether an agreement is a lease agreement or contains a lease transaction is based on its contents. The Bank analyses agreements to decide whether delivery under the agreement involves the use of a specific asset or assets and transfers the right to use such assets.

The Bank as lessee

In the context of operative lease schemes the lessor does not essentially transfer the Bank all risks and benefits associated with ownership. Lease payments pursuant to an operative lease transaction are recognized in the expenditure item on a straight-line basis throughout the terms of the lease. Contingent lease fees are recognised as expense when incurred.

Asset held under finance leases are initially recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated statement of financial position as a finance lease obligation.

The Bank as lessor

Leases where the Group transfers substantially all the risks and rewards incident to ownership of the asset to the lessee are classified as finance leases. The net investment in finance leases provided by the Group is included in loans and advances to customers. A receivable is recognized over the leasing period of an amount equalling the present value of the lease payment using the implicit rate of interest and including any guaranteed residual value. All income resulting from the receivable is included in interest income in the statement of profit or loss.

j) Acquisitions and goodwill

Business combinations are accounted for using the purchase method of accounting. This involves recognizing identifiable assets (including previously unrecognized assets) and liabilities (including contingent liabilities) of the acquired business at fair value. A negative difference is recognised directly in the earnings for the year of the acquisition. Goodwill is measured as the excess of the sum of the consideration transferred the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquire (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

Initially goodwill is measured at cost. Following initial recognition, the Bank runs an impairment test annually and measures goodwill at cost less any accumulated impairment.

An asset is identifiable if it is separable or arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

If the subsidiaries acquired are later disposed of, the difference between the selling price and the net assets plus cumulated translation difference and goodwill is recognized in the statement of profit or loss.

k) Investment property

Investment properties are initially reported at cost, taking transaction costs into consideration. Cost includes purchase price and any other direct expense related to the transaction. Direct expenses include, for instance, fees paid for legal services, property transfer tax and other transaction costs. Subsequent to initial recognition investment properties are remeasured at fair value.

l) Tangible and intangible assets

Tangible (fixed) and intangible assets are presented at cost, less accumulated depreciation, and less impairment if any. Depreciation is charged to the statement of profit or loss in the period to which it relates. Depreciation is computed using the straight-line method over the estimated useful lives of the assets considering residual value, as follows:

Real estate	2%
Leasehold improvement	6%
Equipment and furniture	9% - 33%
Software	10% - 33%
Rights representing assets	3.5% - 16.7%
Agency cooperation	5% - 7%
Hardware	33% - 50%
Vehicles	20% - 33%
Other fixed assets	9% - 14.5%

Intangible assets have a definite useful life, excluding goodwill.

m) Impairment of non-financial assets

On the balance sheet date the Bank assesses if there is any indication of impairment. If there is, or in cases where an annual impairment test is required the Bank estimates the recoverable amount of the asset. Recoverable amount is the fair value of the asset net of the costs of sale, or the value in use, whichever is higher. Where the carrying amount of an asset exceeds its recoverable amount, the Bank recognises impairment on the asset, by this the carrying amount is written down to the recoverable amount. When determining value in use the estimated future cash flows are discounted to their present value considering current market assessment of the time value of money and the risks specific to the asset. The appropriate valuation method is applied for the determining fair value net of cost of sales. Several assessments are used to underpin these calculations such as listed share prices or other available fair value indicators.

All figures in tables are in HUF million except otherwise noted

Each asset is assessed annually, when any indication of a reversal or reduction of earlier impairment is performed. If there is such an indication the Bank estimates the recoverable value of the asset. Reversal of previously entered impairment is only done in cases where there has been a change in the estimates applied for determining the asset's recoverable value since the last reporting of impairment. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of profit or loss. Impairment losses relating to goodwill cannot be reversed in future periods.

n) Derivatives

A derivative transaction is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instrument, reference yield or index, it is settled in a future date and there is no or low initial investment.

Derivatives are recorded at fair value and carried as assets when their fair value is positive or as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in 'Net trading result'. The resulting gain or loss is recognised immediately in 'Net trading result'.

Derivatives include forwards, futures, swaps and options.

o) Hedge transactions

The Bank makes use of derivative instruments to manage exposures to interest rate, foreign currency and credit risk, including exposures arising from forecast transactions and firm commitments. In order to manage particular risks, the Bank applies hedge accounting for transactions which meet specified criteria.

Upon concluding the hedge contract the Bank drafts the hedge document that sets forth the relationship between the transaction and the instrument hedged. The document describes the nature of risk as well as the risk management goals and strategies. The document also sets forth the method of measuring hedge effectiveness.

Once the hedge is established as relationship, the Bank assesses whether the hedge transaction is expected to be effective in the long term in meeting the fair value attributable to the risk hedged or in offsetting cash flow changes. Hedges are reviewed by the responsible banking department on a quarterly basis. A hedge transaction is considered effective if, as a result, the fair value attributable to the risk hedged or the cash flow change offset by the hedge is within a range of 80-125% in the period to which the hedge refers.

For the purposes of hedge accounting, hedges are classified into two categories:

(a) Fair value hedges which hedge the exposure to changes in the fair value of a recognized asset or liability; and

(b) Cash flow hedges which hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecasted transaction.

There are no net investment hedges in foreign operations.

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 the Consolidated Comprehensive Income Statement along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk.

In relation to cash flow hedges, which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized initially in the other comprehensive income item. The gains or losses on effective cash flow hedges recognized initially in other comprehensive income are either transferred to the statement of profit or loss in the period in which the hedged transaction affects the statement in the profit or loss, or are included in the initial measurement of the cost of the non-financial related asset or liability. The ineffective portion is recognized in the statement of profit or loss.
Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognized in other comprehensive income remains in other comprehensive income until the forecasted transaction occurs. Where the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognized in other comprehensive income is transferred to the net profit/loss for the period.

For hedges, which do not qualify for hedge accounting (economic hedges), any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the statement of profit or loss for the period.

The following lines in the profit or loss statement contain the gains or losses in connection with the hedging instruments of hedges (swaps):
(a) Interest income or interest expense
(b) Gains or losses from foreign exchange transactions
(c) The remaining change from fair value adjustment in Change in fair value of derivatives

p) Current tax

Current taxes include the corporate income tax, local business tax and innovation contribution payable and refundable amounts and are measured at the amount expected to be recovered from or paid to the tax authorities. The rates applied are in accordance with the provisions of the Hungarian taxation law.

q) Deferred taxes

Deferred tax is provided on temporary differences at the balance sheet date between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes. All deferred tax liabilities are recognized. Deferred tax assets are recognized only to the extent that it is probable that taxable profit will be available against which it can be utilized. Deferred tax assets and liabilities are measured at the enacted tax rates that are expected to apply in the year when the asset is realized or the liability is settled. Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current taxes liabilities and the deferred tax relate to the same company and the same tax authority.

r) Classification into financial liabilities or shareholders' equity

Financial liability is any liability that is:
- a contractual obligation:
    - to deliver cash or another financial asset to another entity; or
    - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

s) Financial liabilities carried at amortized cost

The Bank has the following financial liabilities to finance its business: issued mortgage bonds, issued bonds, loans from the Hungarian state, interbank loans and customer deposits.
Financial liabilities, which are not designated at fair value through profit or loss, are classified as financial liabilities carried at amortized cost. At initial measurement, they are recognized at fair value. After initial measurement, they are carried at amortized cost using the effective interest rate. Amortized cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

t) Financial liabilities carried at fair value other than derivatives

On initial recognition the management designates the financial liabilities into financial liabilities designated at fair value through profit or loss category. Management may only designate an instrument at fair value through profit or loss upon initial recognition when the following criteria are met, and designation is determined on an instrument by instrument basis:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognising gains or losses on them on a different basis;
- the liabilities are part of a group of financial liabilities, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy;
- the financial instrument contains one or more embedded derivatives, which significantly modify the cash flows that otherwise would be required by the contract.

Such financial liabilities are issued mortgage bonds, bonds and interbank loans (that are economically closely related to the swaps, which are entered to mitigate risks). Financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in fair value are recorded in 'Change in fair value of derivatives'. Interest is earned or incurred is accrued in 'Interest income' or 'Interest expense', respectively, using the effective interest rate (EIR).

Included in this classification are mortgage bonds and bonds issued which are managed on a fair value basis, where the nominal value represents the contractually required payments. The change in fair value other than movement in portfolio or currency represents credit risk.

u) Financial guarantee contracts

Financial guarantee contracts are those contracts that require a payment to be made to reimburse the holder for a loss incurred because the specified debtor fails to make a payment when it is due in accordance with terms of a debt instrument.
Financial guarantee contracts are initially recognised in the financial statements within 'Provisions' at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee.

Subsequently, the liability is measured at the amount recognised less cumulative amortisation, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

The financial guarantee fee received is recognised in the statement of profit or loss in 'Fee and commission income' on a straight line basis over the lifetime of the guarantee. Any increase in the liability relating to financial guarantees is recorded in the statement of profit or loss in 'Credit loss expense'.

v) Derecognizing of financial instruments

A financial asset (or a part of a financial asset or a group of financial assets) is derecognized when

- the rights under contract related to the cash flows from the financial asset cease; or
- the rights under contract related to the cash flows from the financial asset are transferred; or an obligation is undertaken by virtue of a transfer agreement to pay the cash flows from the financial asset to third parties; and
- the Bank has transferred substantially all risks and rewards of the asset; or
- the Bank has not retained nor transferred substantially all risks and rewards associated with the asset but has transferred control of the asset.

If the Bank has not retained nor transferred substantially all risks and rewards associated with the asset but has retained control of the financial asset, it continues to recognize the transferred asset in proportion to its continuing involvement. The rate of continuing involvement in a transferred asset is the Bank's rate of exposure to the risks associated with changes in the value of the transferred asset.

When the Bank continues to report the transferred asset in proportion to its continuing involvement it also reports an associated liability.

A financial liability (or a part of a financial liability) is derecognized when it ceases, is executed or matured. Exchange or partial exchange of existing financial liabilities or a part thereof with significantly different terms and conditions or significant modification of its terms and conditions is also considered as cessation of the financial liability and is reported as a new financial liability, taking the relevant part of IAS 39. The difference between the book value of, and the consideration paid for financial liabilities (or a part thereof) that ceased or have been transferred to third parties is reported in the profit or loss.

w) Repurchase and reverse repurchase transactions

The Bank purchases securities under agreements to resell at a specified future date, these securities are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within 'Due from banks', reflecting the transaction's economic substance as a loan by the Bank. The difference between the purchase and resale prices is recorded in 'Net interest income' and is accrued over the life of the agreement using the effective interest rate.

The Bank does not report securities provided to repo as a separate item in the balance sheet, only in the Notes.

x) Provisions

Provisions are recognized when the Bank has present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Expense relating to lending provision is a part of provision for impairment losses on loan expense. On provision for contingent liabilities related to business combinations is recognized in other operating expense.

y) Short term employee benefits

Under the Bank's policy, the employer must grant employees their paid leave in the period the leave is earned, except for the paid leave emerges during maternity leave. Deferment of the expected cost of leave is applicable to the Bank and its subsidiaries, but this cost is recognized only if it is material.

z) Long term employee benefit plans- pensions

In the normal course of business the Bank pays fixed contributions into the Hungarian State and private pension funds on its employees, which is recognized in social security contributions (mandatory contribution) and other personnel expenses (voluntary contribution) and which cannot be considered as employee benefit plan. The Bank itself does not offer a pension scheme or post-retirement benefit plan, and consequently has no legal or contractual obligation to make further contributions.

aa) Repurchased treasury shares

Treasury shares represent the cost of shares of the Bank repurchased and are displayed as a reduction of shareholders' equity. Treasury shares are accounted for at weighted average cost. Premiums and discounts on repurchase and subsequent disposal are credited and debited directly to retained earnings, no gain or loss is recognized in the statement of profit or loss.

bb) Share-based payment

The Bank has developed a share option scheme to remunerate its Directors, executives and specific managers for their services. The scheme involves transfer of treasury shares at a discount.

The Bank reports share option benefits extended in shares at the fair value on the day the benefit was approved by the Annual General Meeting (AGM), calculated by means of the methodology described in Note 34, in accordance with IFRS 2, Share-base Payment. The fair value of shares involved in the share option scheme but not yet delivered is recognized as expenditure (other personnel costs) as a separate line item against share option reserve under shareholders' equity for the period the benefit is earned.

The cumulative expenditure on share option is based on the period earned until the balance sheet date and the Bank's estimate regarding the number of shares earned. In the case of treasury shares provided with market terms the Bank recognizes proceeds received from a party who meets all other requirements of earning irrespective of whether the market requirement is met or not.

Regarding the share-based payments from 2015 the following rules come into force. The entitled person may exercise his option in the period of 3 years from the general meeting closing the business year given. In the first year of the entitlement the person shall be entitled to draw maximum 60% of the option, and one year after the first drawing, the person shall be entitled to draw maximum 20%, and after another year, the person shall be entitled to draw the 20% of the option left.

cc) Income and expenditure

Interest income and interest expenditure (the interest subsidy received from the Hungarian State or from the client) are recognized time-proportionately using the effective interest rate method. Interest income and interest expense include the amortization of discount or premium on securities.

The effective interest rate is the rate which exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Fees directly related to loans are reported in the calculation of effective interest rate. Fees referring only to a particular period are accrued. Fees attached to particular deliveries are considered as a lump sum once the criteria are met.

dd) Interest subsidy

State interest subsidy

Interest subsidy is available to clients who have been granted loans in accordance with the specific provisions of the Hungarian legislation (Government Decree 12 of 2001). There are two types of interest subsidy: mortgage bond's interest subsidy and supplementary interest subsidy. Both methods are designed to reduce the interest payable by the client. The mortgage bond's interest subsidy being based indirectly on the bank's costs (mortgage bond's interest subsidy), and the supplementary interest subsidy on the actual amount of interest payable by the client (asset side subsidy).

Both types of subsidies are presented in the Bank's revenues, thus the Bank only passes on these subsidies to the clients as they pay a lower-than-market interest rate to the Bank. The interest subsidy is available for a period not exceeding the first 20 years of a loan.

A new Hungarian legislation became effective from 1 January 2007 under which a 5% withholding tax is to be paid for the interest income on subsidized mortgage loans. This additional tax is reported in 'General and administrative expenses'.

Mortgage bond interest subsidy

The mortgage bond interest subsidy is available for housing loans up to the stipulated amounts and based on conditions as specified in the government decree 12/2001 and calculated in accordance with the criteria set. The condition of the maximum interest percentage payable by the customer also has to be met. The subsidy is available for housing loans eligible for subsidy as specified in the decree such as:

i. Mortgage loans granted by the Bank or with partner banks; and
ii. Independent and separated liens purchased by the Bank then repurchased by the partner bank under refinancing arrangements, and for receivables from the repurchased part(s) of lien packages.

The subsidy is available on a monthly basis up to the total of mortgage bonds outstanding in the given month. The underlying calculation is based on the daily balance of subsidized loans or mortgage bonds.

Supplementary interest subsidy

The amount of supplementary interest subsidy and the underlying calculation method thereof (reflecting the maximum interest) are laid down in the contract between the Bank and the client. The monthly interest subsidy is one-twelfth of the prevailing subsidized outstanding principal as determined by the amount of the non-due repayable principal as of the date of the transaction.

ee) Contingent liabilities / contingent assets

Consequent to the Group's business, contingent liabilities are not recognized in the financial statements but are presented in the Notes. They are disclosed unless the possibility of an outflow of resources embodying financial gains is remote. Contingent liabilities are reported in the balance sheet when it becomes probable.

Likewise, a contingent asset is not recognized in the financial statements but disclosed when an inflow of financial gains is probable.

ff) Post balance sheet events

Post-balance sheet events that provide additional information about a Group's position at the balance sheet date (adjusting events) are reflected in the financial statements. Post-balance sheet events that are not adjusting events are disclosed in the Notes when material.

gg) Segment information

An operating segment is a component of an entity:
(a) that engages in business activities from which it may earn revenues and incur expenses;
(b) whose operating results are reviewed regularly by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and
(c) for which discrete financial information is available.
Operating segments can engage in business activities that have not yet generated income; for instance foundation related transactions can be pre-income operating segments.

The Bank takes the following factors into consideration when determining whether services are interconnected: nature of services, type or group of clients buying the services, methods applied in the course of service provision, and the regulatory environment. The Bank presents each segment whose contribution to (internal and external) revenue, earnings or balance sheet total is material, in consideration of other material provisions of IFRS 8 (Note 53). The data related to the business segments of own lending and refinancing, are separated in the balance sheet (under Notes 18 and 19) and in the statement of profit or loss (under Note 4).
Geographical segmentation has also been analyzed. Since the revenue, earnings or balance sheet total of the German branch office and the Croatian subsidiaries are under 10%, no presentation of geographical segmentation has been made.

hh) Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, therefore, the related assets and liabilities are presented gross in statement of financial position.

ii) Foreign currency translation

The reporting currency of the Bank is HUF referred to 2.3.

The Bank and its subsidiaries recognize initially currency transactions in their functional currency valid on the transaction day. Monetary assets and liabilities denominated in currencies other than the company's functional currency are converted to the functional currency at the exchange rate on the balance sheet date. Any difference is reported in the profit or loss. Items other than monetary reported at cost are converted at the rate on the initial day of the transaction. Non-monetary items reported at fair value are converted at the rate on the date fair value was determined.

In the course of consolidation, assets and liabilities of foreign companies are converted to HUF on the reporting date at the NBH rate on the balance sheet date. Items of the profit or loss statement are converted at the annual weighted NBH rate. The currency difference is reported in other comprehensive income. The currency difference is released from other comprehensive income and transferred to profit or loss when the foreign company is dissolved or sold.

jj) Trade date and settlement date accounting

A regular purchase or sale of a financial asset is recognized on the date of delivery. Exemptions are derivatives where recognition of purchase is done on the day when the deal is contracted. The date of settlement is the day on which the Bank Group takes possession of the asset. A regular sale or purchase transaction is a transaction where the asset sold and purchased must be delivered within a set interval prescribed by law or as customary in the market.

kk) Bank tax

In August 2010 the Hungarian Parliament approved an Act called the "bank tax". Each financial institution that already had a closed financial year and related financial statements on 1 July 2010 is subject to assessment and payment of this bank tax.

For 2016 and 2015 the basis and rates are uniformly based on statutory reported financial data of the reporting entity as at and for the period ended 31 December 2009, which can be decreased by decreasing items under the Act.

The amount of Bank tax does not include any decreasing items in 2016 and in 2015.

The Bank tax is presented as other operating expense in the Consolidated Statement of Profit or Loss because it does not meet the definition of income tax according to IFRS.

2.7 Significant accounting judgements and estimates

The preparation of financial statements in conformity with IFRS requires using of estimates and assumptions that affect the amounts reported in the financial statements and notes thereto. Although these estimates are based on management's best knowledge of current event and actions the actual results may differ from those estimates. Estimates are applied in the following areas:

Going concern

The Bank's management assessed the Bank's capabilities to continue operation and found that the Bank has the resources necessary for continued operation in the foreseeable future. Furthermore, the management is not aware of any significant uncertainty that might raise serious doubts in respect of the Bank's ability to exist as a going concern.

Fair value of financial instruments

In cases where the fair value of financial assets and liabilities are not measured at marked to market, other kind of assessment model is necessary to be used to determine fair value. Wherever possible, the input of these models is observable market data. Where such data are not available the Bank uses valuation model to determine fair value. (Note 37)

Share-based payment

When establishing the fair value of shares involved in the share option scheme the Bank assesses the allocation condition, the allocation price, and compliance with the trading and profit objectives. (Note 34)

Deferred tax assets

Deferred tax assets are recognized in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Judgment is required to determine the amount of deferred tax asset that can be recognized, based upon the likely timing and level of future taxable profits, together with future tax planning strategies. (Note 11)

Loan impairment test and its result

The Bank assesses whether it is necessary to set up provisions for impairment of loans and advances to customers. The management makes the relevant decision in view of estimations of amounts and future cash flows. When estimating future cash flows the Bank makes judgments regarding the debtor's financial situation and the net sales price of the collateral.

For the loans and advances that have been assessed individually and found not to be impaired as well as for individually insignificant loans and advances, impairment is also assessed on a portfolio basis, if necessary, taking into consideration the type and classification of loan into homogeneous categories based on clearly defined transaction risks, non-performance history and losses.

Impairment of other assets

The Bank assesses the existence of possible impairment of assets. The Bank estimates the recoverable value of the asset. Recoverable value is the fair value of the asset net of the costs of sale, or the value in use, whichever higher.

When determining value in use expected cash is discounted in consideration of the time value of cash and asset-specific risks.

Each asset is assessed annually (except stated otherwise), when any indication of a reversal or reduction of earlier impairment is assessed. If there is such an indication the Bank estimates the recoverable value of the asset.

For more details see Notes 22 and 23.

Investment property marked to market

Investment properties are initially reported at cost, taking transaction costs into consideration. The Bank prepares a yearly assessment based on a mainly statistical basis using comparable market prices to assess the market value of that part of the investment property portfolio that was not recognised during the current period. Based on the assessment the difference between the carrying amount and the assessed market value of the real estates in the portfolio is determined. In case the average variance on the tested portfolio specimen is less than 10%, the assessed market value is not recognised in the statement of profit or loss. In case the average variance of the tested portfolio specimen exceeds 10%, the variance in the carrying amount of the real estate is recognised against the statement of profit or loss for solely those investments where the variance is individually greater than 10%. Revaluation is always done by qualified and experienced experts.

2.8 Reclassification and error

After the balance sheet date of the consolidated financial statements of 2015 there were no mistakes or errors discovered which are significant and affect the decision made by the users based on the financial statements.

2.9 Changes in the legal and regulatory environment and its effect on the financial statements of the Group

On 1 September 2015 entered into force Act CV of 2015 on the debt settlement of natural persons (personal insolvency act) aim to pay off the loans and instalments of indebted natural persons using the necessary wealth and income, re-establish the solvency - out of court and / or in court debt settlement proceedings - according to the statutory frameworks of the act. Actually the Bank Group has 48 in-process debt settlement proceeding.

From 1 July 2015 Home-admittance Subsidy of Families (Családi Otthonteremtési Kedvezmény, "CSOK") is available with the aim of - as former version - supporting the families with children for the home-admittance, but the subsidy contains significant innovations compared to the previous subsidy of social policy. The non-reimbursable one-time grant is applied for new home purchase, construction, purchase of a second hand home and extension. The subsidy is depends on several factors, for example the number of children, useful floor area and energy rating of house.

Since 30 June 2015 FHB Group started among firsts to provide the newly introduced, for broader number of people relevant Home-admittance Subsidy of Families (Családi Otthonteremtési Kedvezmény, CSOK) and there was a huge demand for the new subsidy in 2015. As a result of Home-admittance Subsidy of Families (CSOK) more than 2,400 requests were accepted and, out of that, almost 1,700 remittances were performed in the sum of 4.4 billion HUF from the commencement of the program in June 2015 to December 2016. More than 50% of requests were associated with loan applications which were requested by our customers.

3. CHANGE IN ESTIMATES

There are not any significant areas, where there is any material change in estimates.

4. INTEREST AND SIMILAR INCOME AND EXPENSE

	2016	2015
Interest income		
Loans and advances to customers	19,493	22,453
Refinanced mortgage loans	4,878	7,234
Due from banks	1,137	3,847
Interest income on assets carried at amortised cost	*25,508*	*33,534*
Securities held for trading	1,615	1,025
Financial assets available-for-sale	1,260	1,334
Interest on derivative transactions	359	5,266
Interest income on assets carried at fair value	*3,234*	*7,625*
Total	**28,742**	**41,159**

Accrued interest receivable on impaired loans amounted to HUF 50 million (2015: HUF 479 million).

	2016	2015
Interest expense		
Mortgage bonds	9,673	11,506
Due to banks	115	141
Interest paid on deposits	2,369	4,615
Interest on bonds	2,906	5,108
Interest expense on leases	-	85
Interest expense on liabilities carried at amortised cost	*15,063*	*21,455*
Interest on derivative transactions	949	3,334
Mortgage bonds	474	1,171
Interest on bonds	-	571
Interest expense on liabilities carried at fair value	*1,423*	*5,076*
Total	**16,486**	**26,531**

The interest income from loans and refinanced mortgage loans includes HUF 4,290 million interest subsidy in 2016 (2015: HUF 6,323 million).

All figures in tables are in HUF million except otherwise noted

5. FEE AND COMMISSION INCOME AND EXPENSE

	2016	2015
Fee and commission income		
Mortgage loans of the Bank	598	581
Refinanced mortgage loans*	1,097	166
Handling commission	150	110
Real estate appraisal fee	300	219
Deposit fee income	3,375	3,027
Agency fee income	371	404
Card business	1,525	1,362
Investment services	1,796	1,589
Postal giro (PEK) commission	469	466
Other	495	428
Total	**10,176**	**8,352**

**Include one-off fees related to repayment of refinanced loans of AXA Bank.*

	2016	2015
Fee and commission expense		
Investment services	848	214
Agency fees and commissions	493	418
Card business	651	497
Fees and commissions to banks and to clearing house	205	195
Surety / guarantee fee	-	1
Other	15	9
Total	**2,212**	**1,334**

6. OTHER OPERATING INCOME

	2016	2015
Income from sold property	25	-
Income from damages compensations received	428	142
Rental income on property	173	179
Invoiced expenses and services	791	620
Reversal of provision	235	-
Income from gained cause	-	95
Other	564	361
Total	**2,216**	**1,397**

All figures in tables are in HUF million except otherwise noted

7. OTHER OPERATING EXPENSE

	2016	2015
Bank tax (detailed in a) below)	4,189	5,457
Impairment of non-financial assets	1,107	30
Provision for expected liabilities (Note 31)	908	164
Donation	32	35
Tax penalty, late penalty	215	153
Supervisory and other fees	1,147	798
Loss on sold inventory	10	223
P&L effect of settlement and forint conversion in other operating expense	654	4 313
Other	943	218
Total	**9,205**	**11,391**

a) Bank tax

The amount of Bank tax booked for 2016 by group members is detailed in the following table:

	2016
FHB Mortgage Bank Plc.*	1,144
FHB Commercial Bank Ltd.**	3,010
FHB Lízing Ltd.	35
Total	**4,189**

*Include the contribution payable by credit institutions, based on the Paragraph 4/B. of Act LIX. of 2006.
**Include the contribution payable by credit institutions, based on the Paragraph 4/B. of Act LIX. of 2006 and the obligation of financial transaction levy, based on the Act CXVI. of 2012.

All figures in tables are in HUF million except otherwise noted

8. GENERAL AND ADMINISTRATIVE EXPENSES

	Note	2016	2015
Staff costs	9	7,883	6,680
Marketing and advertising		894	956
General and administrative costs		2,195	2,379
Rental fee	10	1,088	1,113
Depreciation	22	341	446
Amortisation	23	134	1,264
Consultancy fees		785	877
Maintenance costs		5,371	4,133
Other taxes		96	56
Insurance fees		31	52
Database system usage		267	220
Other		460	588
Total		**19,545**	**18,764**

9. STAFF COSTS

	2016	2015
Wages and salaries	5,545	4,707
Social security contribution	1,681	1,425
Other personnel related payments	657	548
Total	**7,883**	**6,680**

Social security contribution is payable by the Bank based on gross wages and salaries paid to employees. The consolidated full time head count of the Bank at the end of the reporting period was 996 (2015: 864).

All figures in tables are in HUF million except otherwise noted

10. RENTAL FEE (OPERATING LEASE)

Non-cancellable operating leases

The operating lease agreement of the registered office expires on 31 December 2019.

	31 December 2016	31 December 2015
	Minimum lease payments	Minimum lease payments
Within 12 month	2,304	2,511
Between 1 and 5 years	1,846	2,434
Over 5 years	775	775
Total	**4,925**	**5,720**

	Minimum lease payments	Contingent rents	Sublease payments	Total
Expense in the period 2016	1,108	-	(20)	1,088
Expense in the period 2015	1,130	-	(17)	1,113

All figures in tables are in HUF million except otherwise noted

11. INCOME TAX

	31 December 2016	31 December 2015
Current income tax	**924**	**1,831**
Corporate income tax	112	243
Local business tax	714	1,388
Innovation contribution	98	200
Deferred tax expense/(benefit)	**5,258**	**1,007**
Total	**6,182**	**2,838**

Reconciliation of expected tax based on book earnings and actual tax paid is presented as follows:
The Act LXXXII of 2016 on the amendment of Act LXXXI of 1996 on Corporate Tax Act modified the tax rate from 19% to 9%. The modification was announced on 20 December 2016 (effective date 1 Januar 2017).
Based on this information the Group calculated the deferred tax with the 9% tax rate in 2016 and with the 19% tax rate in 2015.

Based on the business plans of the Management the profit of the Group in the foreseeable future will cover the accumulated deferred tax assets from tax loss carry forward. Based on the assumption the recognition of the deferred tax benefits is reasonable.

	31 December 2016	31 December 2015
Loss before tax	*(9,320)*	*(7,711)*
Calculated corporate income tax (19%)	(1,771)	(1,465)
Local business tax and innovation contribution	812	1,591
Effect of local business tax and innovation contribution to the corporate income tax	(155)	(302)
Items modifying the Hungarian tax base	3,451	3,608
Items modifying because of investments accounted for using the equity method	(46)	(123)
Subsidiaries' tax losses not to be carried forward	3	(26)
Effect of deferred tax rate	4,131	-
Effect of other modifications	(243)	(445)
Total income tax expense/(benefit)	**6,182**	**2,838**

All figures in tables are in HUF million except otherwise noted

Deferred tax position

	31 December 2016				
	Deferred tax assets	Deferred tax liabilities	Deferred tax net position	Income statement effect	Deferred tax position in reserves
Disbursement fee	371	-	371	(822)	-
Revaluation of annuity related investment property	-	-	-	-	-
Annuity costs	-	-	-	-	-
Derivatives	162	-	162	(346)	-
Impairment	(247)	-	(247)	401	-
Suspended interest	(401)	-	(401)	887	-
Acquisition	(41)	-	(41)	51	-
Tax loss carried forward	3,741	-	3,741	(5,440)	-
Effect of consolidation	(632)	-	(632)	20	-
AFS securities	24	-	24	69	(3)
Finance leases	-	-	-	-	-
Deferred tax of foreign subsidiaries	55	-	55	(79)	-
Net deferred tax position	**3,032**	**-**	**3,032**	**(5,258)**	**(3)**

All figures in tables are in HUF million except otherwise noted

	31 December 2015				
	Deferred tax assets	Deferred tax liabilities	Deferred tax net position	Income statement effect	Deferred tax position in reserves
Disbursement fee	1,193	-	1,193	(241)	-
Revaluation of annuity related investment property	-	-	-	(21)	-
Annuity costs	-	-	-	-	-
Derivatives	508	-	508	322	-
Impairment	(648)	-	(648)	292	-
Suspended interest	(1,287)	-	(1,287)	581	-
Acquisition	(92)	-	(92)	6	-
Tax loss carried forward	9,181	-	9,181	(2,276)	-
Effect of consolidation	(652)	-	(652)	368	-
AFS securities	(44)	1	(45)	17	(133)
Finance leases	-	-	-	(58)	-
Deferred tax of foreign subsidieries	73	-	73	3	-
Net deferred tax position	**8,232**	**1**	**8,231**	**(1,007)**	**(133)**

All figures in tables are in HUF million except otherwise noted

12. OTHER COMPREHENSIVE INCOME

Components of other comprehensive income

	31 December 2016	31 December 2015
Other comprehensive income		
Financial asset available-for-sale	30	699
including: change in fair value	45	488
including: reclassification to profit or loss	(15)	211
Foreign currency translation	(18)	-
Deferred tax effect	(1)	(133)
Total	**11**	**566**

Deferred tax effects relating to other comprehensive income

	31 December 2016			31 December 2015		
	Before tax amount	Deferred tax	Net of tax amount	Before tax amount	Deferred tax	Net of tax amount
Other comprehensive income						
Financial assets available-for-sale	30	(3)	27	699	(133)	566
Foreign currency translation	(18)	2	16	-	-	-
Total	**12**	**(1)**	**11**	**699**	**(133)**	**566**

All figures in tables are in HUF million except otherwise noted

13. BALANCES WITH THE NATIONAL BANK OF HUNGARY

Under the Decree No. 10/2005. (11. June) of the National Bank of Hungary (NBH) banks are required to reserve deposit in the NBH, based on the balance/level of their customer deposits and other liabilities/sources which falls under the reserve requirements at a rate of 1% (obligatory).

	31 December 2016	31 December 2015
Short term deposits	45,252	162,084
Nostro account at National Bank of Hungary	15,358	521
Accrued interest for the period	25	144
Total	**60,635**	**162,749**

14. DUE FROM BANKS

	31 December 2016	31 December 2015
Nostro accounts	3,018	2,595
Term deposits	67,238	45,607
Accrued interest for the period	33	6
Total	**70,289**	**48,208**

15. SECURITIES HELD FOR TRADING

	31 December 2016	31 December 2015
Hungarian Government bonds	9,598	7,007
Hungarian Treasury bills	3,996	119
Hungarian Development Bank bonds	22,014	42,902
Mortgage bonds	602	212
Investment notes	188	185
Student Loan Centre Ltd. bond	1,014	506
Bonds issued by MOL Plc.	1,510	982
Foreign bonds	1,812	-
Total	**40,734**	**51,913**

All figures in tables are in HUF million except otherwise noted

16. FINANCIAL ASSETS AVAILABLE-FOR-SALE

	31 December 2016	31 December 2015
Hungarian Government bonds	11,488	26,352
Hungarian Discount Treasury bills	22,148	15,104
Domestic issued bonds	18,235	19,835
Investment funds	455	460
Foreign bank bonds	11,489	9,316
Equity investments	2,480	2,975
Total	**66,295**	**74,042**

Equity investments include shares of BIF Ltd. for HUF 1,211 million (2015: HUF 1,134 million), shares of DOM-P Zrt. for 705 million HUF, shares of MPT Security Zrt. for 385 million HUF, shares of SZHISZ for 20 million HUF (2015: HUF 20 million), shares of Garantiqa Creditgurantee Ltd. for HUF 30 million (2015: HUF 30 million) as well as SWIFT shares for HUF 1 million (2015: HUF 1 million) and VISA Europe shares for HUF 130 million (2015: HUF 726 million). The investment in DOM-P Zrt. represents 13.91% stake, in BIF Ltd. 10% stake, in MPT Security Zrt. 10% stake, the other investments represent less than 1% stake in the companies. Shares of Garantiqa and SZHISZ measured at cost according to IAS 39.46 (c).

17. SALE AND PURCHASE OF SUBSIDIARIES, CHANGE IN THE GROUP OWNERSHIP INTEREST IN SUBSUDIARIES

Purchase of subsidiaries

There was no purchase of subsidiaries in 2016 and in 2015.

Sale of subsidiaries

There was no sale of subsidiaries in 2016 and in 2015.

Change in the Group's ownership interest in a subsidiary

There was no change in the Group's ownership interest in any subsidiaries in 2016 and in 2015.

18. REFINANCED MORTGAGE LOANS

Act L of 2001, which amended other acts providing for financial organizations, introduced substantial changes to Act XXX of 1997 on Mortgage Loan Companies and Mortgage Bonds, modifying the role of commercial banks in the provision of mortgage loans. The substance of the amendment was, that the self-lien backed receivables appeared as collateral for mortgage bonds, parallel the modified act allowed the sale and purchase of these self-liens themselves. Thus mortgage banks are able to refinance the mortgage loans of commercial banks.

All figures in tables are in HUF million except otherwise noted

The Bank signed contracts with several major Hungarian commercial banks to refinance mortgage loans; hence state subsidized the mortgage loans are available through the entire network of these commercial banks. Later, FHB Mortgage Bank refinanced also market rate (not supported) mortgage loans. In the fourth quarter of 2016 the refinanced portfolio changed significantly due to the sale of the total balance related to one of our refinanced partner bank. The partner bank refinanced loan portfolio also has been transferred to another commercial bank with the effective date of November 1, 2016. The refinanced loan portfolio of the Mortgage Bank decreased by HUF 35.5 billion because of this transaction and amounted to HUF 100.79 billion (with the refinanced loan portfolio of FHB Commercial Bank) at the end of the year. The balance as at 31 December 2016 includes loans disbursed to 27,207 customers (2015: 37,369). The refinanced mortgage loans are provided to seven partner institutions (among them FHB Commercial Bank).

19. LOANS AND ADVANCES TO CUSTOMERS

	31 December 2016	31 December 2015
Housing loans	110,464	115,821
General purpose mortgage loans	80,832	94,877
Customer loans and overdrafts	11,190	6,871
Loans to employees	1,299	1,306
Finance lease to retail customers	2,738	2,724
Finance lease to companies	2,120	1,397
Finance lease for capital equipment	4,550	1,313
Loans to companies	104,076	82,792
Corporate capital equipment loan	571	699
Loans gross subtotal	**317,840**	**307,800**
Fair value adjustment of hedged items	43	11
*Accrued part of disbursed loans under Funding of Growth Scheme**	*3,898*	*5,070*
Derecognition	(3,784)	(2,196)
Accrued interest	8,143	10,142
Amortized origination cost	(3,916)	(5,972)
Loans gross total	**318,326**	**314,855**
Loan impairment	(23,853)	(26,557)
Loan portfolio reported	**294,473**	**288,298**

*The disbursed loans under Funding for Growth Scheme started in June 2013. Related to Funding of Growth Scheme the total disbursed loan is HUF 28.5 billion at the end of year 2016. The Bank booked these disbursed loans and the liabilities to NBH at fair value at initial recognition, and accrued the difference between fair value and contractual value until the end of maturity in line with IAS 39 AG76.

Loan impairment based on individual rating: HUF 14,258 million (2015: HUF 6,162 million), based on portfolio rating: HUF 9,595 million (2015: HUF 20,395 million).

All figures in tables are in HUF million except otherwise noted

The Integrational Organization of Cooperative Credit Institutions (SZHISZ) prescribed for the FHB Group on the rating date of 31 December 2016, that average loss coverage of outstanding loans with overdue over 90 days must reach 70%.

Changes in impairment for credit losses:

	31 December 2016	31 December 2015
Impairment as at 1 January	26,557	38,669
Provision for impairment in the period	10,318	8,284
Exchange rate change of impairment	(104)	2,859
Reverse of impairment for the period	(7,919)	(15,999)
Derecognition due to foreign currency loans conversion to HUF at a fixed rate	(1,588)	(2,196)
Derecognition due to sale of assets	(3,411)	(5,060)
Impairment as at end of period	**23,853**	**26,557**

Breakdown of the credit loss expense for the period

	31 December 2016	31 December 2015
Change of impairment in the period*	2,400	(7,715)
Entries due to consolidation	-	(3)
Losses from the repayment of the loans at a fixed rate	11	6
Written-off loans	1,768	3,002
Loss on loans sold	4,007	5,463
Loss on terminated loans	96	(19)
Charge for commitments	(90)	128
Credit losses on loans and advances	**8,192**	**862**

* The abovementioned change of impairment in the period does not include the derecognition related to forint conversions, the effect of derecognition due to the sale of assets and the foreign exchange difference on impairment (which is recognised on the Profit/(loss) from foreign exchange transactions line in the Consolidated Statement of Profit or Loss).

The aggregate amount of non-performing loans was HUF 34,260 million as of 31 December 2016 (31 December 2015: HUF 47,019 million).
Within the total balance of mortgage loans 99.04% have maturity over five years (2015: 99.05%), exceeding the minimum level of 80% that is required by the Section 5(1) of Act XXX of 1997 on Mortgage Loan companies.

The total outstanding mortgage loan principle does not exceed 70% of the aggregate collateral value of real estate determined at loan disbursement that is required by the Section 5(3) of Act XXX of 1997 on Mortgage Loan Companies. As of 31 December 2016, loan to value is 29.83% (31 December 2015: 32.07%).

All figures in tables are in HUF million except otherwise noted

Finance Lease

	31 December 2016	31 December 2015
Gross investment in the lease	11,642	7,651
Minimum lease payments	11,642	7,651
Net investment in the lease	9,325	5,206
Unearned finance income	**2,317**	**2,445**
Impairment on finance leases	(122)	(187)

The minimum lease payments receivable at 31 December 2016 for the following periods

	Within 12 month	Between 1 and 5 years	Over 5 years
Gross investment in the lease	1,984	5,327	4,331
Net investment in the lease	1,622	4,355	3,348
Unearned finance income	**362**	**972**	**983**

The minimum lease payments receivable at 31 December 2015 for the following periods

	Within 12 month	Between 1 and 5 years	Over 5 years
Gross investment in the lease	837	2,588	4,225
Net investment in the lease	552	1,687	2,966
Unearned finance income	**285**	**901**	**1,259**

20. GOODWILL

	31 December 2016	31 December 2015
Gross value		
Opening balance	152	152
Increase	-	-
Purchased through acquisition	-	-
Decrease	-	-
Closing balance	**152**	**152**
Impairment		
Opening balance	-	-
Increase	-	-
Closing balance	-	-
Net value	**152**	**152**

The goodwill is attributable to Diófa Fund Management Ltd. According to the impairment test on “Diófa goodwill” no additional impairment are reported.

HUF 5,183 million goodwill and HUF 847 million goodwill impairment, which one is attributable to FHB Invest Ltd. is classified among shares in associates and joint ventures (Notes 29).

All figures in tables are in HUF million except otherwise noted

21. INVESTMENT PROPERTY

Investment properties are reported in conjunction with the Bank's annuity services.

	31 December 2016	31 December 2015
Gross value		
Opening balance	780	-
Increase	-	780
Decrease	-	-
Closing balance	**780**	**780**
Revaluation adjustment		
Opening balance	-	-
Increase	-	-
Decrease	-	-
Closing balance	-	-
Net value	**780**	**780**

The methods and significant assumptions applied in determining the fair value of investment properties were supported by market evidence, therefore they have been categorized as Level 2 instruments, as the Bank used similar assets' prices for valuation base from market obtainable inputs. FHB provides property price index to compare similar real estates in the market and the investment properties were revalued independently by relevant professional experts as at 31 December 2016.

All figures in tables are in HUF million except otherwise noted

22. TANGIBLE ASSETS 31 December 2016

	Property and Leasehold improvement	Office equipment	Total
Gross value			
Opening balance	7,781	3,702	11,483
Increase	29	216	245
Decrease	-	(78)	(78)
Closing balance	**7,810**	**3,840**	**11,650**
Depreciation			
Opening balance	1,534	3,323	4,857
Annual depreciation	188	153	341
Decrease	-	(48)	(48)
Closing balance	**1,722**	**3,428**	**5,150**
Impairment			
Opening balance	447	11	458
Increase	1,100	-	1,100
Closing balance	**1,547**	**11**	**1,558**
Net value	**4,541**	**401**	**4,942**

TANGIBLE ASSETS 31 December 2015

	Property and Leasehold improvement	Office equipment	Total
Gross value			
Opening balance	7,892	4,715	12,607
Increase	14	276	290
Decrease	(125)	(1,289)	(1,414)
Closing balance	**7,781**	**3,702**	**11,483**
Depreciation			
Opening balance	1,359	3,744	5,103
Annual depreciation	187	259	446
Decrease	(12)	(680)	(692)
Closing balance	**1,534**	**3,323**	**4,857**
Impairment			
Opening balance	447	324	771
Decrease	-	(313)	(313)
Closing balance	**447**	**11**	**458**
Net value	**5,800**	**368**	**6,168**

All figures in tables are in HUF million except otherwise noted

23. INTANGIBLE ASSETS 31 December 2016

	Software	Other intangible assets	Agency cooperation	Total
Gross value				
Opening balance	3,787	874	645	5,306
Increase	218	43	-	261
Decrease	-	-	-	-
Closing balance	**4,005**	**917**	**645**	**5,567**
Amortisation				
Opening balance	2,909	467	167	3,543
Annual amortisation	68	34	32	134
Decrease	-	-	-	-
Closing balance	**2,977**	**501**	**199**	**3,677**
Impairment				
Opening balance	-	-	-	-
Increase	-	-	-	-
Reversal	-	-	-	-
Closing balance	**-**	**-**	**-**	**-**
Net value	**1,028**	**416**	**446**	**1,890**

INTANGIBLE ASSETS 31 December 2015

	Software	Other intangible assets	Agency cooperation	Total
Gross value				
Opening balance	17,862	907	645	19,414
Increase	293	28	-	321
Decrease	(14,368)	(61)	-	(14,429)
Closing balance	**3,787**	**874**	**645**	**5,306**
Amortisation				
Opening balance	8,731	451	135	9,317
Annual amortisation	1,188	44	32	1,264
Decrease	(7,010)	(28)	-	(7,038)
Closing balance	**2,909**	**467**	**167**	**3,543**
Impairment				
Opening balance	1,923	-	-	1,923
Increase	-	-	-	-
Reversal	(1,923)	-	-	(1,923)
Closing balance	**-**	**-**	**-**	**-**
Net value	**878**	**407**	**478**	**1,763**

All figures in tables are in HUF million except otherwise noted

In the context of the impairment test of intangible assets the Bank reviewed projects in the course of construction but not yet capitalized by 31 December 2016. It was established that each project relating to intangible assets is progressing according to plan. Use of the products that are the expected outcome of the projects is certain, and none of the projects will be terminated without generating the expected outcome. In 2016 no impairment was reported on intangible assets. At the end of June 2015 the Group reentered a lease contract with DOM-P Ltd. (the former Exo-BIT Ltd.), the leased IT software was derecognised, due to the change of the lease classification.

24. OTHER ASSETS

	31 December 2016	31 December 2015
Prepaid expenses	697	1,195
Reclaimable taxes	1,352	815
Settlements with the Hungarian State	284	538
Repossessed collateral	758	647
Debtors	710	1,246
Deposits	3,487	2,040
Receivables from investment services	331	623
Other	1,066	965
Total	**8,685**	**8,069**

The balance of settlements with the Hungarian State includes one month's interest subsidy due from the State and not yet settled as of 31 December 2016 (one months in 2015), decreased by the advance on it.

Significant part of the deposits was provided to ensure the turnover on cards to Card companies.

In case of properties held for sale and repossessed collaterals the Group endeavours to sell the properties as soon as possible.

25. DUE TO BANKS

	31 December 2016	31 December 2015
Long term loans received	36,149	26,999
Short term loans received	6,886	7,359
Accrued part of disbursed liabilities under Funding for Growth Scheme*	4,177	5,414
Accrued interest	17	2
Total	**47,229**	**39,774**

* See Notes 19.

All figures in tables are in HUF million except otherwise noted

26. ISSUED SECURITIES

The Group reports mortgage bonds and bonds that are recognised at amortised cost on 'Issued securities' line in the statement of financial position.

	31 December 2016		31 December 2015	
	Gross book value	Face value	Gross book value	Face value
Non-listed mortgage bonds				
Fixed interest	16,667	16,449	33,184	33,050
Floating interest	-	-	-	-
Listed mortgage bonds				
Fixed interest	69,956	63,620	103,413	94,858
Floating interest	40,850	40,958	31,868	31,886
Total mortgage bonds	**127,473**	**121,027**	**168,465**	**159,794**
Non-listed bonds				
Fixed interest	19,586	19,564	20,326	20,275
Floating interest	-	-	9,567	9,612
Subordinated bonds	-	-	-	-
Listed bonds				
Fixed interest	14,912	14,955	23,584	25,949
Floating interest	1,883	1,885	3,980	5,235
Total bonds	**36,381**	**36,404**	**57,457**	**61,071**
Accrued interest (*mortgage bonds*)	3,667	-	6,127	-
Accrued interest (*bonds*)	2,762	-	3,066	-
Total issued securities	**170,283**	**157,431**	**235,115**	**220,865**

Mortgage bonds

All figures in tables are in HUF million except otherwise noted

Mortgage bonds are transferable registered or bearer securities and, pursuant to Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds, can be issued only by mortgage banks. Prior to their issue, a property supervisor reviews if the Bank has adequate collateral for the issue. These collaterals may be (i) ordinary collaterals such as the principal and interest receivable (including interest subsidies) from mortgage loans provided in accordance with the standard collateral requirements, the repurchase price of an independent lien and the related refinancing interest, and (ii) additional collateral such as, typically, government bonds and related interest and any principal and interest receivable guaranteed by the government. According to the Act, if the amount of principal receivable exceeds 60% of the collateral value of related property offered, only the principal receivable amounting to 60% of the collateral value and the proportionate amount of interest can be considered as an ordinary collateral. The Act governs the proportionate between ordinary and additional collaterals: at least 80% of all collateral must be ordinary collateral. In addition to the statutory requirements, the Bank's internal policies regulate that the following limits also need to be met:

(i) Cover for the nominal value: the nominal value of the ordinary collateral (the underlying principal excluding the provision for any impairment loss and interest) should exceed 100% of the not yet repaid nominal value of the mortgage bonds outstanding,

(ii) If point (i) is not met, the Bank has to acquire additional collateral to the extent that the sum of the nominal values of the ordinary and additional collaterals always exceed 100% of the not yet repaid minimal value of the mortgage bonds outstanding,

(iii) Cover for the interest: the interest on the nominal value of the ordinary and supplementary collaterals should exceed 100% of the interest on the not yet repaid nominal value of the mortgage bonds outstanding.

In addition to assessment of the nominal value of the cover for mortgage bonds the Mortgage Loans Act also provides for assessment of mortgage bonds cover at present value. The fair value of collateral exceeded the present value of mortgage bonds outstanding not yet repaid throughout the period.

Bonds

From 2007 the Group launched bonds for the first time in addition to mortgage bonds.

Bonds are registered dematerialized securities. Pursuant to the provisions of Act CXX of 2001 on Capital Markets as amended and of Government Decree No. 285 of 2001 (26 December) the Group generates a document containing the data of the bond series. The document, which itself is not a security, is then deposited with Central Clearing House and Depository Ltd. (KELER).

Bonds incorporate the Group's direct, unconditional, non-subordinate unsecured liabilities. Bonds are equal in rank to the Group's other outstanding unsecured non-subordinate liabilities at any time in the hierarchy of repayment in the event of bankruptcy, voluntary liquidation or foreclosure except for liabilities, which have precedence on the basis of the governing laws on voluntary liquidation or other relevant statutory provisions.

27. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS, EXCEPT DERIVATIVES

The Group reports mainly mortgage bonds and bonds measured at fair value on 'Financial liabilities at fair value through profit or loss' line in the statement of financial position. (Description is included in Point 26 of Notes.)

Such financial liabilities are issued mortgage bonds, bonds and interbank loans (that are economically closely related to the swaps, which are entered to mitigate risks and not classified as the hedged item in hedging). The contractually required payment at maturity to the holder of the obligation is the face value of these financial liabilities. Interest is earned or incurred is accrued in 'Interest income' or 'Interest expense', respectively, using the effective interest rate. The change in fair value other than attributable to change in market conditions, that give right to market risk represent credit risk.

	31 December 2016		31 December 2015	
	Fair value	Face value	Fair value	Face value
Listed mortgage bonds				
Fixed interest	11,991	10,519	19,878	17,415
Floating interest	-	-	-	-
Total mortgage bonds	**11,991**	**10,519**	**19,878**	**17,415**
Total Financial liabilities at fair value through profit or loss, except derivatives	**11,991**	**10,519**	**19,878**	**17,415**

The total credit risk was HUF 371.6 million as of 31 December 2016 (31 December 2015: HUF 380.7 million in 2015).

28. DEPOSITS FROM CUSTOMERS

As a lending institution the Bank holds deposits from clients. The deposit portfolio is as follows:

	31 December 2016	31 December 2015
Current accounts	139,874	124,754
Term deposits	156,604	203,336
Accrued interest	594	958
Total	**297,072**	**329,048**

All figures in tables are in HUF million except otherwise noted

29. SHARES IN ASSOCIATES AND JOINT VENTURES

	31 December 2016	31 December 2015
Opening balance	7,755	6,932
Capital increase in joint ventures	40	200
Increase from associates*	-	2
Share of profit of joint ventures and associates**	(2,979)	621
Closing balance	**4,816**	**7,755**

*This increase from associates include the direct interest of MA-TAK-EL Magyar Takarék Ellátó Ltd. in 2015.
**Share of profit of joint ventures and associates include dividend payment of HUF 3,570 million.

The general requirement of IFRS 12 disclosed in Note 2.4.

Summarized financial information in respect of each of the Group's material associate and joint venture set out below.
The summarized financial information below represents amounts shown in the associate and joint venture financial statement prepared in accordance with IFRS.

All figures in tables are in HUF million except otherwise noted

Magyar Takarék Befektetési és Vagyongazdálkodási Ltd.	31 December 2016	31 December 2015
Current assets	617,584	775,790
Non-current assets	30,979	6,155
Current liabilities	615,743	770,586
Non-current liabilities	8,240	-
Revenue	45 439	59 933
Profit/loss from the continuing operation	3,791	3,991
Profit/loss of the year	3,445	3,991
Other comprehensive income of the year	(760)	(548)
Total comprehensive income of the year	2,685	3,442

Díjbeszedő Faktorház Ltd.	31 December 2016	31 December 2015
Current assets	7,513	13,939
Non-current assets	11	66
Current liabilities	1,418	1,339
Non-current liabilities	7	435
Revenue	3,224	3,405
Profit/loss from the continuing operation	868	272
Profit/loss of the year	868	272
Other comprehensive income of the year	-	-
Total comprehensive income of the year	868	272

Magyar Posta Befektetési Szolgáltató Ltd.	31 December 2016	31 December 2015
Current assets	3,833	2,940
Non-current assets	17	18
Current liabilities	3,379	2,468
Non-current liabilities	-	-
Revenue	1,771	1,154
Profit/loss from the continuing operation	(147)	(281)
Profit/loss of the year	(147)	(281)
Other comprehensive income of the year	-	-
Total comprehensive income of the year	(147)	(281)

All figures in tables are in HUF million except otherwise noted

30. FINANCE LEASE LIABILITIES

In the Group structure FHB Services Ltd. owned all of the IT assets and software which were used by the related parties. On 1 December 2011 after the sale of the FHB Services Ltd. the Group entered a lease contract with Exo-BIT Ltd. (the former FHB Services Ltd.) regarding the lease of the IT assets and software. At the end of June 2015 the Group reentered a lease contract with DOM-P Ltd. (the former Exo-BIT Ltd.), the leased IT software was derecognised.

The book value of the leased assets is the following:

	31 December 2016		31 December 2015	
	Tangible assets	Intangible assets	Tangible assets	Intangible assets
Book value	3	-	12	-

The structure of the leasing payment and payable amounts can be found in the table below.

	31 December 2016		31 December 2015	
	Minimum lease payments	Present value	Minimum lease payments	Present value
Within 12 months	3	3	6	6
Between 1 and 5 years	-	-	6	6
Over 5 years	-	-	-	-
Total	3	3	12	12
Present value of minimum lease payments	3	3	12	12

The present value of minimum lease payments is calculated by the Bank on a cash flow basis discounted by the valuation yield curve. This amount represents the present value of the minimum lease payments.

In 2016 there were no subleasing contracts and suspended rental fees regarding the leased assets.

31. PROVISIONS

Provisions are set up mainly for current and contingent liabilities. Provision is also set up for a pending lawsuit. The changes in provisions are accounted for in credit loss expense (Note 19) or in other operating expense (Note 7).

All figures in tables are in HUF million except otherwise noted

2016	Credit risk provision	Contingent liabilities	Other provision	Expected costs of legal cases	Total
Opening balance	522	302	10	165	999
Increase in the period	564	-	914	7	1,485
FX movement	(1)	-	-	-	(1)
Utilization in the period	(689)	(91)	-	(157)	(937)
Closing balance	**396**	**211**	**924**	**15**	**1,546**

The credit risk provision in 2016 is attributable to the off-balance sheet items. The Bank has joined to the rationalization project initiated by the Magyar Takarékszövetkezeti Bank Ltd. Due to this the Bank set up HUF 908 million provision for the organizational changes related to the project.

2015	Credit risk provision	Contingent liabilities	Other provision	Expected costs of legal cases	Total
Opening balance	360	883	23,805	156	25,204
Increase in the period	1,294	161	6	17	1,478
FX movement	3	-	(242)	-	(239)
Utilization in the period	(1,135)	(742)	(23,559)	(8)	(25,444)
Closing balance	**522**	**302**	**10**	**165**	**999**

The credit risk provision in 2015 is attributable to the off-balance sheet items.

32. OTHER LIABILITIES

	31 December 2016	31 December 2015
Taxes payable	822	721
Creditors	584	511
Accrued expenses	914	642
Liability from investments services	1,464	1,314
Customer loan prepayments	625	727
Other liabilities to Joint Venture company	-	3,570
Other	1,690	1,667
Total	**6,099**	**9,152**

All figures in tables are in HUF million except otherwise noted

33. SHARE CAPITAL

In the fourth quarter of 2016 the ownership structure of the Bank Group was significantly altered. On 14 October 2016 the A64 Vagyonkezelő Ltd. sold its shares to B3 Takarék and Fókusz Takarék within an OTC transaction and on 09 December 2016 Magyar Takarékszövetkezeti Bank Ltd. purchased the shares of VCP Finanz Holding Ltd. After the transactions the ownership of Magyar Takarékszövetkezeti Bank Ltd. and the saving cooperatives increased to over 68%. As of 31 December 2016 the Bank's share capital consists of series “A”, “B” and “C” shares. Domestic institutional investors have the majority of shares (78.2%).

The ownership structure of the Bank as at 31 December 2016 and 31 December 2015 was as follows:

	31 December 2016		31 December 2015	
Shareholder	Holding %	Number of shares	Holding %	Number of shares
Ordinary shares (Series “A”)				
Domestic institutional investors	39.0	42,345,991	38.6	41,911,917
Foreign institutional investors	10.7	11,597,658	10.7	11,642,388
Domestic private investors	5.9	6,435,206	6.2	6,669,193
Foreign private investors	0.0	22,330	0.0	16,326
Employees, directors and senior management	0.1	87,963	0.0	77,808
Government held owner	4.5	4,832,225	4.5	4,832,225
Treasury shares	0.2	253,601	0.2	253,601
Other	0.4	425,036	0.6	596,552
Subtotal	*60.8*	*66,000,010*	*60.8*	*66,000,010*
Dividend preference shares (Series “B”)				
Domestic institutional investors	13.1	14,163,430	13.1	14,163,430
Subtotal	*13.1*	*14,163,430*	*13.1*	*14,163,430*
Ordinary shares (Series “C”)				
Domestic institutional investors	26.1	2,832,686	26.1	2,832,686
Subtotal	*26.1*	*2,832,686*	*26.1*	*2,832,686*
	100.0	***82,996,126***	***100.0***	***82,996,126***

All figures in tables are in HUF million except otherwise noted

a) The following amounts were used in the calculation of earnings per share:

	31 December 2016	31 December 2015
Loss of shareholders of the Bank	(11,048)	(8,304)
Change of general reserve	-	-
Attributable profit	**(11,048)**	**(8,304)**
Weighted average number of shares	108 236 699	65,862,821

Earnings per share ratio is calculated as the profit attributable to shareholders of the Bank divided by the weighted average number of shares outstanding during the period excluding treasury shares. For the diluted earnings per share figure the profit attributable to shareholders and the weighted average number of shares outstanding needs to be adjusted by all of the potentially diluting securities. For the normal earnings per share figure the profit attributable to shareholders means the result for the year decreased by the amount of the general reserves which is divided by the number of the shares excluding the number of the treasury shares by the Bank. Shares to managers on the context of the share-based payment are allocated from Treasury shares and require no new issues and thus have no diluting effect on EPS. Based on the contractual conditions the Capital Securities issued at 20 December 2012 does not dilute the EPS in 2015. The Bank has no dilutive potential ordinary shares. Earnings per share figure therefore equals to the diluted earnings per share figure.

b) Treasury shares purchased

	31 December 2016	31 December 2015
Opening balance	207	207
Purchase	-	-
Closing balance	**207**	**207**

c) Other reserves

	Note	31 December 2016	31 December 2015
Share premium		27,926	27,926
Additional tier 1 capital	33	-	31,749
Change in fair value of financial assets available-for-sale	33	611	584
Foreign currency translation reserve		(2)	14
Total other reserves		**28,535**	**60,273**

All figures in tables are in HUF million except otherwise noted

Other reserve includes the Capital Securities issued by the Bank in 2013 and 2012. On May 16 2013 the Bank tapped the series of Euro-denominated perpetual floating rate bonds – which was issued with a total face value of EUR 102 million on 20 December 2012 – in an aggregate nominal amount of EUR 10 million in a private placement for non-Hungarian investors. The rate of interest on the bonds is linked to the 5-year-euro swap rate as reference rate. The non-cumulative interest on the bonds is payable annually in arrear and cancellable in the discretion of the Bank. The Capital Securities constitutes additional tier 1 capital and unsecured obligations of the Bank. The Capital Securities are redeemable after five years by the Bank and in certain cases they converted into ordinary shares, but do not have dilutive effects. On 17 June 2016 the Bank repurchased subordinated Tier 1 capital bond with a nominal value of EUR 112 million formerly reported as part of shareholder's equity.

Due to the conditions described above, the Capital Securities was accounted as equity instrument and therefore any payment is accounted as equity distribution paid to the holders of the Capital Securities.

d) Financial assets available-for-sale reserve

	31 December 2016	31 December 2015
Opening balance	584	18
Net unrealised gains on available-for-sale assets	30	699
Net realised losses on available-for-sale assets	-	-
Deferred tax	(3)	(133)
Closing balance	**611**	**584**

e) Non-controlling interest

	31 December 2016
Opening balance	21,480
Dividend payment to NCI	(214)
Share of profit/(loss) of the year	(4,454)
Closing balance	**16,812**

Non-controlling interest detailed by subsidiaries

Name of the subsidiary	The proportion of ownership interests held by non-controlling interests	The profit or loss allocated to non-controlling interests of the subsidiary during the reporting period	Accumulated non-controlling interests of the subsidiary at the end of the reporting period
FHB Commercial Bank Ltd.	49%	(4,353)	17,007
Diófa Alapkezelő Ltd.	11%	(1)	(143)
Diófa Ingatlankezelő Ltd.	11%	-	1
Magyar Kártya Szolgáltató Ltd.	49%	(100)	(53)
Total		**(4,454)**	**16,812**

All figures in tables are in HUF million except otherwise noted

34. SHARE-BASED PAYMENTS

Share options are granted to employees and also others providing similar services, it is difficult to estimate the fair value of those benefits that are coming from these services, therefore the Group measures the fair value by reference to the fair value of the equity instruments granted.
The Group has a one-year share based incentive scheme for 2016 built on four IFRS measured criteria: increase of the owner's equity, decrease of the proportion of the non-performing loans and increase in ROA and ROE. For all of these indicators there are minimum levels quantified by the General Meeting, every criterion is deemed to be met if the actual KPI exceeds the minimum level (in case of the proportion of the non-performing loans the actual KPI should be less). At least three out of the four criteria have to be met to be entitled to the share based payment. If the share option is realised, the payment will depend on the individual performance evaluations, so only a specific proportion of the total distributable volume will be paid. The preferential price of drawing the option is 25% of the average price on the Budapest Stock Exchange between 1 January of the subject year and the date of the General Meeting closing the business year in prior of the subject year weighted by the turnover. The share option regarding both years can be realised in the following 3 years based on the following rates 60%-20%-20%.
The expense recognised for share based payments during 2016 is zero, because the above mention KPI doesn't exceed the minimum level.

35. GENERAL RESERVE

In accordance with statutory requirements, the Bank and other credit institutions within the Group are required to set up a non-distributable general reserve equal to 10% of statutory profit after tax. Increases in the general risk reserve are separated from retained earnings, as calculated under Hungarian regulatory rules, and thus are not charged against income. According to the Section 13 (8) of the Government Decree No. 250/2000 (XII.24.) on the specifics of the annual reporting and bookkeeping tasks of investment companies are required to release the general reserve when loss after tax deduction occurs. The amount of the General reserve is HUF zero as at 31 December 2016.

36. COMMITMENTS

To meet the financial needs of customers, the Bank enters into various irrevocable commitments and contingent liabilities. Even though these obligations may not be recognised on the statement of financial position, they do contain credit risk and are therefore part of the overall risk of the bank.

Off-balance sheet commitments comprise of loans not drawn and other contracted future payments to suppliers of the Group:

	31 December 2016	31 December 2015
Guarantees	11,649	15,248
Loan commitments	51,864	49,449
Total	**63,513**	**64,697**

All figures in tables are in HUF million except otherwise noted

37. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of the on- and off-balance sheet financial assets and liabilities:

Financial instruments stated at amortized cost: due to short-term maturity profiles, the carrying values of certain financial assets and liabilities were assumed to approximate their fair values. These include cash and due from banks and with the National Bank of Hungary as well as deposits.

The following shares disclosed under investment are reported at cost: shares of Garantiqa Creditguarantee Ltd., and shares of Integration of Savings Cooperatives the total value of these is HUF 51 million (2015: HUF 51 million). The BIF Ltd. shares, the DOM-P Ltd., and MPT Security Ltd. shares disclosed (2016: HUF 2,301 million 2015: HUF 2,198 million) under investment are reported at fair value. Visa shares are reported at fair value for HUF 130 million in 2016 (2015: HUF 726 million).

Financial assets available-for-sale: Financial assets available-for-sale held for liquidity purposes are marked to market. For investments traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the balance sheet date. For investments where there is no quoted market price, a reasonable estimate of the fair value is determined by reference to the current market value of another instrument which is substantially the same, or is based on the expected discounted cash flows.

a) Loans and advances to customers and refinanced mortgage loans:

The Bank calculates the fair value of loans and advances to customers and refinanced loans at amortized cost on an individual basis.

The applied valuation model takes into account the following:

- The scheduled and calculated repayments, with certain restrictions
- The interest and interest type revenues until maturity, including the interest subsidies of the loans and their unique legal regulation;
- In addition, the loans qualifying for subsidy based on the rules valid before 16 June 2003 and between June 16 and 22 December 2003 according to the Law are treated by the model as practically non re-priced for 20 years due to the fix interest ceiling of 5-6%;
- The subsidy cash flows related to the loans have been calculated until maturity of the loans but for a maximum of 20 years;
- In case of loans re-priced the model treats the loans as matured at the date of re-pricing, therefore the Bank does not calculate with interest or subsidy further on.

The cash flow series calculated in this way are discounted with the yield curve applied in the Bank's evaluation. The net value of assets, i.e. the fair value of the total portfolio of loans is determined by combining and exchanging to HUF the FX values.

	31 December 2016		31 December 2015	
	Gross book value	Fair value	Gross book value	Fair value
Refinanced mortgage loans	31,423	36,962	82,790	96,686
Loans and advances to customers	318,326	357,720	314,855	349,442

Gross book value does not include the decreasing effect of impairment.

b) Fair value of mortgage bonds and bonds carried at amortised cost

The fair value of mortgage bonds and bonds is calculated by the Bank on a cash flow basis. In the calculations the Bank identifies the cash flows of the mortgage bonds discounted by the valuation yield curve. This is considered as the fair value of mortgage bonds.

In case of floating rate mortgage bonds the expected interest rates are estimated on a forward basis including interest premium. The interest cash flow calculated and the principal repayments are discounted to present value using the valuation yield curve.

For the valuation yield curve the Bank calculates the yield of own securities – denominated in Hungarian forint and Euro taking into account secondary market quotations, the yields of the secondary deals and the spreads regarding to the issues on primary markets. Based on these yields the Bank position management system calculates the yield curves for the different currencies and bond types (mortgage bond and several unsecured bonds).

The change in fair value is mainly due to the changes in market conditions. Based on this the change in fair value attributable to credit risk is not material.

All figures in tables are in HUF million except otherwise noted

	31 December 2016		31 December 2015	
	Net book value	Fair value	Net book value	Fair value
Non-listed mortgage bonds				
Fixed interest	17,715	20,199	34,362	38,102
Floating interest	-	-	-	-
Listed mortgage bonds				
Fixed interest	72,505	91,786	108,294	139,317
Floating interest	40,920	70,808	31,936	42,487
Total mortgage bonds	**131,140**	**182,793**	**174,592**	**219,906**
Non-listed bonds				
Fixed interest	21,371	25,709	22,091	26,363
Floating interest	-	-	9,567	9,692
Subordinated bonds	-	-	-	-
Listed bonds				
Fixed interest	15,886	25,600	24,873	30,213
Floating interest	1,886	3,143	3,993	5,002
Total bonds	**39,143**	**54,452**	**60,524**	**71,270**
Total issued security	**170,283**	**237,245**	**235,115**	**291,176**

Gross value also includes the accrued interests.

c) Fair value of other items in the statement of financial position

No estimation is made in respect of the fair value of assets and liabilities that are not considered to be financial instruments, such as fixed assets and other assets and liabilities. Given the use of subjective judgement and uncertainties, the fair values should not be interpreted as being realisable in an immediate settlement of the instruments.

d) Fair value of derivative transactions

Swap transactions are contracts between two parties to swap the differences of interests or exchange rates for a fixed amount. In case of interest rate swap (IRS) transactions, parties usually swap the fixed and variable interest payments of a given currency. In FXS, they swap fixed payments and given amounts of different currencies. CCIRSs are swap transactions where parties swap fix amounts in different currencies as well as fixed and variable interest payments.

All figures in tables are in HUF million except otherwise noted

	Fair value		Notional amount	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015
Derivatives designated as cash-flow hedges				
Positive fair value of cash flow hedges	3	-	376	-
Including: CCIRS	3	-	376	-
Swap deals classified as HFT				
Positive fair value of trading swaps	867	620	83,141	45,733
Including: CCIRS	90	507	6,797	31,938
Including: IRS	446	19	53,354	3,812
Including: FXS	331	94	22,990	9,983
Fair value hedge				
Positive fair value of IRS fair value hedge	-	11	-	4,071
Options				
Positive fair value of options	6	2	730	263
Forward deals				
Positive fair value of forward deals	57	251	5,440	23,123
Total derivative financial assets	**933**	**884**	**89,687**	**73,190**

All figures in tables are in HUF million except otherwise noted

	31 December 2016	31 December 2015	31 December 2016	31 December 2015
Derivatives designated as cash-flow hedges				
Negative fair value of cash flow hedges	(4)	-	310	-
Including: CCIRS	(4)	-	310	-
Swap deals classified as HFT				
Negative fair value of trading swaps	(1,277)	(2,246)	45,566	61,372
Including: CCIRS	(318)	(443)	6,165	5,586
Including: IRS	(849)	(1,452)	31,764	34,230
Including: FXS	(110)	(351)	7,637	21,556
Fair value hedge				
Negative fair value of fair value hedges	(115)	(20)	7,931	3,914
Including: CCIRS	-	-	-	-
Including: IRS	(115)	(20)	7,931	3,914
Options				
Negative fair value of options	(6)	(2)	730	263
Forward deals				
Negative fair value of forward deals	(177)	(40)	16,274	12,034
Total derivative financial liabilities	**(1,579)**	**(2,308)**	**70,811**	**77,583**

The fair value of derivative deals is also calculated based on a cash flow basis by the Bank, the derivatives are broken down to elementary cash flows and the present value is calculated.
The present value of the future cash flows of fixed interest rate deals is calculated by the Bank using the zero-coupon swap yield curve corresponding to the appropriate currency. The fair value of swap deals is the difference of the present value of the two series of cash flows not yet due (incoming and outgoing).

In the case of floating rate deals the expected interest rates are estimated on a forward basis including interest premium. The interest cash flow calculated and the principal payments are discounted to present value using the multi-level yield curve (forward yield curve, and discounting curve). The fair value of the deal is the aggregate of the present values.

The risk premium is significant and permanent, it is justified to incorporate it into the evaluation method of swaps. The yield curve is adjusted with the risk premium. The application of the appropriate risk premium enhances the accuracy of the fair value calculation (please also refer to Note 3) taking counterparty and own credit risk into amount (CVA/DVA) in accordance with IFRS 13.

All figures in tables are in HUF million except otherwise noted

Cash flow hedge transactions as defined by IAS 39 have been performed in order to eliminate the risk of foreign currency in case of EUR denominated mortgage bond issuances, thus the cash-flow in currency of booking can be fixed. The main conditions of these swap contracts (maturity, notional amount, currency, interest rate and payment dates, etc.) and consequently the cash flows are identical to those of the underlying hedged instruments.

Swap contracts used for trading purposes are also tied to EUR mortgage bonds. The conditions of the EUR leg of the swap is identical to the mortgage bond as in the case of cash-flow hedge transactions, however, the interest type concerning the liabilities of the swap may be different and the currency is not necessarily the currency of booking.

In case of the valuation of forward security deals the used yield curves are consistent with the nature of the paper in the forward deal (for example in case of government bonds the Bank uses the yield curve of the government bonds).

e) Fair value hedge transactions

31 December 2016

Description of the hedging instrument	Types of hedged items	Fair value of the hedging instrument	Fair value of the hedged items	Gains on the hedging instrument	Losses on the hedged items
IRS	loans and advances to customers	(43)	3,888	(43)	43
IRS	available-for-sale asset	(150)	30	53	30

In the second half of 2015 only four derivative transactions were defined as fair value hedge transaction (IRS), in 2016 only one new IRS was designated as hedging instrument in fair value hedge connection.

31 December 2015

Description of the hedging instrument	Types of hedged items	Fair value of the hedging instrument	Fair value of the hedged items	Gains on the hedging instrument	Losses on the hedged items
IRS	loans and advances to customers	(12)	3,914	(11)	(11)
IRS	available-for-sale asset	3	13	6	13

In 2015 the Group has done the “Forint conversion” according to the Act LXXVII of 2014, the FX retail loans portfolio decreased significantly, because of this the hedge connection was terminated in the first part of 2015. As of 31 December 2015 there were no CCIRS hedge relation designated.

All figures in tables are in HUF million except otherwise noted

f) Fair value of financial instruments carried at fair value

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:
Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments carried at fair value.

	31 December 2016		
	Level 1	Level 2	Level 3
Assets			
Securities held for trading	40,734	-	-
Financial assets available-for-sale	65,840	455	-
Derivative financial assets	-	841	92
Total assets carried at fair value	**106,574**	**1,296**	**92**
Liabilities			
Derivative financial liabilities	-	1,256	323
Financial liabilities at fair value through profit or loss, except derivatives	-	11,991	-
Total liabilities carried at fair value	**-**	**13,247**	**323**

	31 December 2015		
	Level 1	Level 2	Level 3
Assets			
Securities held for trading	51,913	-	-
Financial assets available-for-sale	73,582	460	-
Derivative financial assets	-	377	507
Total assets carried at fair value	**125,495**	**837**	**507**
Liabilities			
Derivative financial liabilities	-	1,865	443
Financial liabilities at fair value through profit or loss, except derivatives	-	19,878	-
Total liabilities carried at fair value	**-**	**21,743**	**443**

All figures in tables are in HUF million except otherwise noted

38. RISK MANAGEMENT

a) Overview

Companies of FHB Group under FHB Mortgage Bank Plc. control and within the scope of prudential consolidation are part of the Group led by Takarékbank Ltd. as parent bank under its prudential supervisory. FHB Mortgage Bank Plc. and FHB Commercial Bank Ltd. are members of Integration Organisation of Cooperative Credit Institution (SZHISZ).

Due to the membership of Integration and the consolidated supervision the scope of the risk management policies of the Integration, as well as risk strategy have been extended to the FHB Group.

Risk Strategy – approved by the Board of Directors of Takarékbank Ltd. is mandatory for credit institutions and companies under consolidated supervision – cover: risk culture, risk taking principles, objectives, risk types, significant risks, risk appetite and risk capacity, risk structure, risk management, the structure and organization of risk management.

The Integration and its member institutions seek to create an integrated risk culture which covering the whole Integration and which is in line with their risk appetite, and their risk tolerance ensure the identification, measurement and management of the emerged risks.

Within the Integration FHB Mortgage Bank Plc. is the leader credit institution of the FHB Banking Group on subconsolidated level. FHB Mortgage Bank Plc. as parent bank controls its direct or indirect investments in Group members. Under the professional control, the Mortgage Bank ensure that the risk management principles, methods, risk evaluation, measurement and control procedures are consistent and harmonized within the Banking Group as well as comply with the regulations of the Integration.

The primary purpose of risk management is to protect the Banking Group's financial strength and reputation, and to support the deployment of capital in competitive business activities, which contribute to the increase of the value of shares. The protection of the financial strength and reputation means, that the risk management limits the impact of negative events to the capital and profit/loss of the Banking Group.

The Banking Group's risk appetite / capacity should be in line with the financial resources that are available to cover potential losses. In order to this, the Banking Group calculate the current and future economic, capital requirements and the capital requirements under Pillar 1 for quantifiable risk types.

Prudent risk taking is a fundamental value for the Banking Group.

In order to achieve its objectives risk management identifies, evaluates and analyses the exposure of the Banking Group and its members. It processes the information gained, develops risk guidelines, and operates risk management systems.

The Banking Group's risk management policy is based on the following main pillars:

- in risk management application of the best approaches and methods applied in market practice
- identification of risk and yield profile of segments, products and risk postions and continuous monitoring
- consideration of the risks in business decisions
- separation the risk management organisation from the business divison
- the importance of all stages of the risk management process
- the risk management process is the part of the Bank Group's management system, its aspects are integrated into the strategic and annual planning.

The Group is exposed to credit-, liquidity-, market- and operation risks.

In 2016 regarding to credit risk in accordance with the aims set the Group managed to increase the portfolio of exposures with prudent and careful risk-taking covering the customer segment available through the strategic partner Magyar Posta in the retail segment. In the corporate segment the FHB could increase the exposures by very good quality portfolio beside low NPL ratio.

To maintain a diversified liability structure in 2016 FHB obtained sources from the capital markets several times through security issue, which replaced the maturing liabilities with long term liabilities. In the deposit portfolio the volume of deposits collected in the Postal network is increasing. The bank disposed significant amount of liquid assets during the year, mainly in form of government securities.

39. RISK MANAGEMENT STRUCTURE

Board of Directors

The Board of Directors is responsible for the Group's risk management policy and strategy. The Board of Directors develops the basic framework rules for risk management and guidelines of applicable methodologies. After the admission to the Integration the FHB Group follows the risk strategy, applies the uniform risk management policies of the Integration and reports about its risks to the central bodies of the Integration – to the Takarékbank Ltd., and the Integration Organisation of Cooperative Credit Institution (SZHISZ).

Based on the reports of the Director responsible for the Bank's prudent operation and on regular risk exposure reports, the Board of Directors evaluates the Bank's operation, and specifically its risk management activities and the level of exposure. If the level of exposure undertaken by the Group does not correspond to the strategy the Board takes measures to contain risks.

Supervisory Board

The Supervisory Board is responsible for monitoring the overall risk and risk management processes within the Bank. In this context it supervises and monitors the suitability of methods and systems applied by the Bank in order to ensure compliance with the statutory capital adequacy requirements.

Group Assets and Liabilities Management Committee (GALCO)

GALCO makes Group level decisions with respect to assets and liability management, risk management, liquidity management and pricing issues.

Department of Risk Management

Risk Management is responsible for determining the requirements necessary for the Group's prudent operation. It develops the risk guidelines and manages lending and operating risk for the Group as a whole and for each company belonging to the Group.

Department of Risk Analysis and Control

The Department is responsible for independent lending risk control. In this context it undertakes tasks related to the development, supervision, validation and review of customer and partner rating systems. Furthermore, it evaluates and estimates risk parameters. It sets the liquidity, interest and exchange rate exposure limits for the Group, monitors compliance with the limits, prepares models and calculations about the capital requirement of the operational risk.

Treasury

Treasury is responsible for ensuring the Group's short-term and long-term liquidity, and for the operative management of liquidity, interest and exchange rate related risks.

Internal Audit

The elements of the internal control system (management control and management information system incorporated in processes, and an independent internal control unit function) cover the Bank's and the group members' all organizational units and are incorporated in day-to-day operation. They are traceable and provide feedback to the appropriate levels of management and control.

Risk management processes are audited annually by the internal audit organization that examines both the adequacy of the procedures and the compliance with the procedures. Internal Audit reports its findings to the Supervisory Board and the Management.

Property supervisor

Prior to the mortgage bond issue, the property supervisor reviews whether the Bank is in possession of adequate collateral for the issue and makes a statement accordingly.

Risk evaluation and reporting system

In areas of risk exposure where appropriate empirical data are available the Group applies statistical methods for the evaluation of risks. Statistical models are used for estimating expected and unexpected losses in most areas of exposure. Losses are evaluated according to a variety of stress scenarios.

In terms of liquidity as well as interest and exchange rate risks, risks are essentially monitored and controlled by means of setting up limits of acceptable exposure. The limits reflect the Group's strategy, willingness to undertake risks, and the market environment. The Group collects and analyses data about events and losses related to risk from operation.
As a result of risk assessment the Bank determines the level of capital justified by the level of acceptable exposure. GALCO evaluates the report on credit risk on a monthly basis. It reviews the reports on compliance with liquidity management limits and assets and liabilities management limits. Comprehensive report on risk from operation risk is submitted on a quarterly basis. The Board of Directors evaluates the risk reports every quarter and exercises professional control over all components of the system through demanding reports from Management. The Supervisory Board evaluates the reports on risks on a quarterly basis. It exercises its function of ongoing control through the Internal Audit Department under its professional supervision.

40. RISK MITIGATION

Interest rate and exchange rate risks

To minimize the risk of interest- and foreign exchange rate risks the Bank manages its asset and liability structure – economical hedging deals – and also enters into derivative contracts.

Credit risk

Credit risk is the risk of the Bank suffering losses because the borrowers (clients or partners) fail to meet their contractual obligation to the Bank.

The Group rates the creditworthiness of its clients and partners and classifies them into client or partner categories. Risk is only accepted if the client's or partner's rating is appropriate. The Group monitors client and partner rating on an ongoing basis.

Retail product development gave rise to standardized loan schemes, which allows simplification of lending risk management. The client portfolios of the resulting products are characterized by large numbers of clients and small amounts of individualized loans. This diversification reduces (diversify also) the credit risk compared to the portfolio size.

Corporate lending is based on individual assessment and the continuous monitoring is in focus.

The Group applies strict regulations to determine the scope of eligible collaterals, their valuation method and the coverage ratio. The collateral value of real estate covering mortgage loans is established by the Bank also for the refinanced loans portfolio.

Risks towards partner banks are minimized by means of bilateral agreements and the assignment of the refinanced loan portfolio as prescribed by law.

Credit risk relating to hedge swaps is limited to the amount of positive fair value over and above margin accounts.

Maximum credit risk exposure based on gross outstanding balances:

	31 December 2016	31 December 2015
Balances with the National Bank of Hungary	60,635	162,749
Dues from banks	70,289	48,208
Securities held for trading	40,734	51,913
Financial assets available-for-sale	66,295	74,042
Shares in associated and joint venture companies	4,816	7,755
Derivative financial assets	933	884
Refinanced mortgage loans	31,423	82,790
Loans and advances to customers	317,840	314,855
Other assets	8,685	8,069
Total	**601,650**	**751,265**
Off-balance sheet commitments	58,645	67,500
Total	**58,645**	**67,500**
Total credit risk exposure	**660,295**	**818,765**

41. CREDIT RISK

The following tables present the Group's receivables and commitments.

	Neither past due nor impaired	Past due or individually impaired	Assessed under collective impairment rules	Total
	31.12.2016	31.12.2016	31.12.2016	31.12.2016
Dues from banks and refinanced mortgage loans	85,311	-	-	85,311
Loans, commitments and guarantees	277,263	63,169	30,541	370,973
To corporate customers	131,943	27,090	-	159,033
To retail customers	145,320	36,079	30,541	211,940
Total	**362,574**	**63,169**	**30,541**	**456,284**

All figures in tables are in HUF million except otherwise noted

The amount of the non-performing loans (Note 19) differs from the amount of the portfolio of past due or individually impaired loans (see above) because the latter contains loans which are due less than 90 days and are not terminated.

	Neither past due nor impaired	Past due or individually impaired	Assessed under collective impairment rules	Total
	31.12.2015	31.12.2015	31.12.2015	31.12.2015
Dues from banks and refinanced mortgage loans	170,244	-	-	170,244
Loans, commitments and guarantees	268,734	68,546	37,411	374,691
To corporate customers	124,966	20,605	-	145,571
To retail customers	143,768	47,941	37,411	229,120
Total	**438,978**	**68,546**	**37,411**	**544,935**

Lending risk exposure of the Bank in terms of internal risk classification

Class	Historic default rate 31.12.2016 (%)	Uncovered 31.12.2016 HUF million	Total 31.12.2016 HUF million
Class 1	0.00	118,725	118,725
Class 2	0.00	8,821	8,821
Class 3	0.00	42,113	70,192
Class 4	0.08	45,983	128,392
Class 5-7	3.34	29,349	227,369
Class	**Historic default rate 31.12.2015 (%)**	**Uncovered 31.12.2015 HUF million**	**Total 31.12.2015 HUF million**
Class 1	0.00	214,623	231,205
Class 2	0.00	15,666	15,666
Class 3	0.00	36,211	99,483
Class 4	0.12	13,612	130,110
Class 5-7	7.19	32,610	215,246

The table shows the Bank gross outstanding loans portfolio (dues from banks, refinanced mortgage loans and other mortgage and unsecured loans and bonds).
In the calculation of risk capital, in accordance with its risk management policy, the Bank classifies its loan portfolio and its weighted off-balance items in different rating categories. Consolidated data based on the International Financial Reporting Standards (IFRS) are used in the classification. Retail customers are rated into seventeen categories (classes). Other partners (mainly credit institutions) are rated into seven categories. The classes are determined based on customer rating policy. The Bank consolidated the two sets of classes in the above table, in this way the historical default rates of the entire portfolio are combined and broken down in terms of rating classes.

The effectiveness of rating systems is reviewed annually. Appropriateness of classification is reviewed on a quarterly basis.

The classification of credit assets into risk grades is based on FHB Group's internal rating system. Internal rating models and risk parameters are developed by internal specialist team. Rating development follows internal methodology, which is controlled continously by the Internal Audit as well as by the supervisory authorities. The Bank applies different rating scales in different segments, but applies a standardized framwork for external riporting, which is mapping the risk classes to the following categories.

Class 1: In practice, only risk-free exposures, governments fall into this category

Class 2: includes first class, nearly risk-free institutional (bank) exposures, which estimated default rate is close to zero. These institutions have typically high (AA) rating from well-known credit rating institutions.

Class 3: includes institutional (bank) low risk exposures, which are not included in previous classes, and their estimated average PD is very low. They are also financially strong, reputed financial institutions that have a good rating.

Class 4:
In this category are included the best qualified retail and corporate customers which default rate is low. These customers have excellent credit history, and a balanced business management (in case of companies).
In case of institutional exposures those exposures which are not included in previous classes and their estimated default rate are low have to be classified to this category.

Class 5-7:
All exposures which are not included in classes 1-4, have to be classified to this category. Observable that within the class close to 90% of the receivables are secured, which influence the actual default rate of loans.

Age analysis of loans past due but not impaired

	5-90 days	5-90 days
	2016	2015
Dues from banks and Refinanced mortgage loans	-	-
Loans	3,492	2,375
Corporate customers	1,117	554
Retail customers	2,375	1,821
Total	**3,492**	**2,375**

As of 31 December 2016 the Company has HUF 11,001 million collateral value for loans past due unimpaired (2015: HUF 6,411 million).

According to the internal policy of the Bank, it is mandatory to set up provision for impairment for transactions that have been past due for at least 90 days. Collaterals are also included in the calculation of impairment.
In accordance with the Group's internal rules and regulations transactions under HUF 10 thousand and past due for less than five days are considered transactions in technical non-default.

All figures in tables are in HUF million except otherwise noted

Forborne loans

Forbearance measures occur in situations in which the contract – receivable is originated from – is modified on the debtor or the Group's initiative, basically based on the fact that the borrower is considered to the unable to service the debt or refinance the contract according to the original terms and conditions because of the debtor's financial difficulties and significant deterioration of ability to pay. Furthermore buffer account loans granted within the framework of the FX rate protection scheme are qualified as forborne as loans, as well as ones concerning to the buffer account loan has been opened.

In comparison with the original term and conditions, essentially more favourable conditions are arising for clients by modification of contract.
Modifications of the terms and conditions can be the following:

- rescheduling the payment
- modification of foreign exchange
- forbearing from collaterals
- capitalization of interest

Rating of forborne loans:

1. If the loans are classified as forborne loans the classification category can not be better than it was before.
2. The forborne loans are classified as “to-be- monitored” if the original loan was classified as “problem-free” or “to-be- monitored” and following the forbearance, the number of days past due did not exceed 15 days in case of corporate loans or 30 days in case of retail loan, respectively, during 180 days without break.
3. The forborne loans are possible to be classified as “problem free” after one year of the forbearance if the number of days past due did not exceed 15 days in case of corporate loans or 30 days in case of retail loan, respectively, during 365 days without break.

An analysis of forborne gross loan portfolio by loan types as 31 December 2016 and 2015

Loan type	31 December 2016	31 December 2015
Individual loans	25,109	33,762
Fx rate protection scheme (original loan)	4,962	5,932
Fx rate protection scheme (buffer account)	306	343
Corporate loans	1,263	2,586
Total	**26,372**	**36,348**

An analysis of impaired forborne loan portfolio by loan types as 31 December 2016 and 2015

Loan type	31 December 2016	31 December 2015
Individual loans	23,735	32,118
Fx rate protection scheme (original loan)	4,024	4,810
Fx rate protection scheme (buffer account)	302	340
Corporate loans	1,082	2,388
Total	**24,817**	**34,506**

See the summary of Fx rate protection scheme in 2.9 note.

An analysis of forborne loan portfolio by loan types and risk classes as 31 December 2016

Loan type	Not past due	1-30 DPD	31-60 DPD	61-90 DPD	91-360 DPD	360+DPD	Total
Individual loans	8,225	1,681	822	370	1,455	12,556	25,109
allowance	*48*	*24*	*130*	*109*	*901*	*9591*	*10,803*
Corporate loans	198	222	91	-	574	178	1,263
allowance	*10*	*1*	*2*	*-*	*133*	*38*	*184*
Total capital of loans	**8,423**	**1,903**	**913**	**370**	**2,029**	**12,734**	**26,372**
Total allowance	***58***	***25***	***132***	***109***	***1,034***	***9,629***	***10,987***

** the table shows just the multiple-forborne loans*

All figures in tables are in HUF million except otherwise noted

Notes to the Consolidated Financial Statements

An analysis of forborne loan portfolio impaired and not impaired by loan types and risk classes as 31 December 2016

Loan type	Not past due			Past due			Total
	Impaired	Not impaired	Total	Impaired	Not impaired	Total	
Individual loans	7,012	1,213	8,225	16,419	465	16,884	25,109
allowance	*48*	-	*48*	*10,755*	-	*10,755*	*10,803*
collateral	*11,124*	*2,564*	*13,688*	*18,058*	*1,409*	*19,467*	*33,155*
Corporate loans	198	-	198	884	181	1,065	1,263
allowance	*10*	-	*10*	*174*	-	*174*	*184*
collateral	*504*	-	*504*	*1,335*	*223*	*1,558*	*2,062*
Total capital of loans	**7,210**	**1,213**	**8,423**	**17,303**	**646**	**17,949**	**26,372**
Total allowance	***58***	**-**	***58***	***10,929***	**-**	***10,929***	***10,987***
Total collateral	***11,628***	***2,564***	***14,192***	***19,393***	***1,632***	***21,025***	***35,217***

** the table shows just the multiple-forborne loans*

An analysis of forborne loan portfolio by type of forbearance as 31 December 2016 and 31 December 2015

	31 December 2016		31 December 2015	
	capital	allowance	capital	allowance
Retail loans	25,109	10,803	33,762	12,090
bridge loan	15,593	7,541	22,242	9,328
Fx rate protection scheme (original loan)	4,962	1,136	5,931	1,118
Fx rate protection scheme (buffer account)	306	159	344	193
Fx housing loan converted to HUF	955	583	1,334	525
other	3,293	1,384	3,910	926
Corporate loans	1,263	184	2,586	492
Total	**26,372**	**10,987**	**36,348**	**12,582**

All figures in tables are in HUF million except otherwise noted

Changes in impairment of forborne loan portfolio

	31 December 2016
Impairment as at 1 January	12,582
Provision for impairment in the period	2,563
Reverse of impairment for the period	(83)
Derecognition due to sale of assets	(4,075)
Impairment as at end of period	**10,987**

42. COLLATERALS AND OTHER MEANS FOR IMPROVING THE LOANS PORTFOLIO

Collaterals for lending risk applied by the Bank:

Real estate collateral
The Group accepts as collateral mortgages, independent or separated liens established mainly on such real estate that is registered in Hungary and have long live stable value and purchase mortgage loans and independent liens with the same conditions. There are some mortgaged real estates registered in Croatia due to the operation of a subsidiary. During the financial leasing the Group finances Hungarian marketable real estates.

Real estate is valued by independent appraisers who are not involved in decision-making regarding the loan. The Group takes real estate into consideration at a conservatively established collateral value.

State guarantee
All instances of State guarantee accepted by the Bank involve joint and several liability set forth by law. The rules governing the guarantee are laid down in statutory provisions.

Deposit
Deposit can take the form of cash, bank deposit or securities.

Other
In addition to the above the Bank also accepts joint and several guarantee by third party (where the third party is other than the Hungarian State). Before the entry in force of the new Civil Code – 15/03/2014 – the Bank accepted assigned claims, lien on claims, home savings assigned to the Bank; insurance (for example property and life insurance) assigned to the Bank, and lien, surety or option on holding or share possessed by the borrower giving the right to participate in company capital. After this date the Bank applies lien on claims (savings, insurances), immaterial goods, chattels, shares.

All figures in tables are in HUF million except otherwise noted

The table below shows the structure of the collaterals in 2016 and 2015:

	31 December 2016	31 December 2015
Mortgage	837,679	1,020,895
Bail	28,978	26,040
Guarantee	6,365	4,228
Other collaterals	2,058	308
Total	**875,080**	**1,051,471**

The above detailed collaterals cover fully the amount of the loans and refinanced mortgage loans.

Among the collaterals the value of mortgage represents the collateral value allocated to the mortgage at disbursement (market value less discount factor) in case of Customer loans. In case of refinanced mortgage loans, mortgage is the lower of the collateral value or the receivable. All other items are valued at their own value (for example the assignment is valued at the amount which was assigned). The category of other collaterals contains the insurances.

43. MARKET RISK

Due to the nature of its business as a mortgage bank and to the special legal regulation relating to it, FHB has distinctive assets and liabilities structure within the Hungarian banking system as the significant part of its assets and liabilities are long-term and raise most of its funds in the capital market.

Regarding the liquidity- and market risk the Bank is responsible for raising the necessary funding sources and for the risk management both on Group level and on individual entity level. The Bank maintains low the maturity-, interest rate- and foreign exchange rate risk derive from the asset, liability and off balance sheet commitments.

44. INTEREST RATE RISK

Interest rate risk derives from interest rate changes, which affect the value of financial instruments. The Bank is also exposed to interest rate risk when the amounts of assets, liabilities and off-balance sheet instruments maturing or re-priced in a particular period are not in harmony. The Bank assesses interest rate risk on a continuous basis with the help of Gap-analysis, VaR calculations and sensitivity analysis. The Bank manages market risk mainly by natural hedging. In addition, active management tools such as repurchase of mortgage bonds, swap transactions as well as issued bonds maturities and interest rates suited to assets are also involved in order to ensure the harmony between assets and liabilities.

All figures in tables are in HUF million except otherwise noted

Average portfolio of interest earning assets and interest bearing liabilities of the Group in the period:

	31 December 2016		31 December 2015	
	Average net A/L	Average interest rate %	Average net A/L	Average interest rate %
Interest earning assets				
Dues from banks and Balances with the National Bank of Hungary	115,948	1.30	222,697	1.96
Securities held for trading and available-for-sale	46,901	7.39	48,202	5.82
Refinanced mortgage loans	68,001	7.18	97,350	7.42
Loans and advances to customers	267,517	7.25	284,094	8.44
Total interest earning assets	**498,367**	**5.87**	**652,343**	**5.89**
Interest bearing liabilities				
Due to banks	79,225	0.09	36,795	0.1
Deposits	299,200	0.79	354,806	1.3
Issued securities and Financial liabilities at fair value through profit or loss, except derivatives	206,085	6.21	284,037	6.16
Other loan	5	-	-	-
Total interest bearing liabilities	**584,515**	**2.60**	**675,638**	**3.28**

Interest rate risk exposure – sensitivity analysis (figures in HUF million)

	Sensitivity of interest income 2016	Sensitivity of equity (2016)				
		0-6 months	6-12 months	1-5 years	Over 5 years	Total
HUF	6	(1.7)	(1.4)	8	22.2	27.1
EUR	0.4	0.3	0.7	(4.8)	(0.8)	(4.6)
CHF	-	-	-	-	(0.1)	(0.1)

	Sensitivity of interest income 2015*	Sensitivity of equity (2015)				
		0-6 months	6-12 months	1-5 years	Over 5 years	Total
HUF	5.4	(0.8)	(0.3)	(2.1)	17.3	14.1
EUR	3.5	(1.0)	0.7	0.6	(1.3)	(1.1)
CHF	0.2	-	-	-	(0.1)	(0.1)

	Sensitivity of interest income 2016 +10 bp	Sensitivity of interest income 2016 +25 bp	Sensitivity of equity (2016) +10 bp	Sensitivity of equity (2016) +25bp
HUF	60	150	271	677
EUR	4	11	(46)	(116)
CHF	-	1	-	(1)

The sensitivity analysis is performed according to the standard method of using 1 base point increase in interest rates, the excursion is symmetric meaning 1 base point decrease in interest rates would result in the same figures with opposite sign.

Sensitivity of net income is the estimated effect of one base point increase in interest rates to net interest income realized in advance over a period of one year, based on floating rate financial assets and liabilities or those financial assets and liabilities to be re-priced next year carried as of the last day of the given year. It means that if interest increase by one basis point from the close of business 31 December 2016 net interest income would increase by HUF 6 million in case of HUF, it would increase by HUF 0.4 million in case of EUR and would increase by HUF 0.04 million in case of CHF.

Sensitivity of equity means the re-valuation of all financial assets and liabilities and off-balance sheet positions based on tenors of maturity and/or repricing. Full-fledged sensitivity of shareholders' equity is based on the presumption that the yield curve moves in parallel, while analysis by maturity groups highlights sensitivity in each tenor segment. The net impact of such moves would cause the increase of the capital by HUF 27.1 million in HUF, the decrease of the capital by HUF 4.6 million in EUR, the decrease of the capital by HUF 0.1 million in CHF.

All figures in tables are in HUF million except otherwise noted

45. EXCHANGE RATE RISK MANAGEMENT

The Mortgage Bank is a specialized credit institution, which narrows the scope of business where exchange rate-related risks may arise. Moreover, the Bank's business policy is to keep exchange rate risk at a low level.

The Bank strives to immediately hedge the exchange risks related to its core business, i.e. mortgage lending, refinancing and financing though mortgage bonds, as allowed by market circumstances. Therefore an open FX position can serve primarily for the purpose of liquidity management, settlements related to lending and refinancing, or active and passive accruals in currencies in which the Bank keeps a nostro account.

FX risk (in the case of 1% increase in exchange rate)

FX	Effect on earning before income tax (31 December 2016)	Effect on capital (31 December 2016)	Effect on earning before income tax (31 December 2015)*	Effect on capital (31 December 2015)
EUR	4	18.7	352.9	365.9
CHF	(2.2)	1.6	(7.6)	18.9

The sensitivity analysis is performed according to the standard method of using 1% increase in foreign exchange rates, the excursion is symmetric meaning 1% decrease in foreign exchange rates would result in the same figures with opposite sign.

Due to the Bank's currency position 1 percent increase in the exchange rate in case of EUR items the estimated net earnings before tax could increase with 4 million HUF, in case of CHF items it could decrease with 2.2 million HUF. The similar effect for the capital could mean an increase of 18.7 million in case of EUR items and 1.6 million HUF increase in case of CHF items. (The sensitivity of the equity means the re-evaluation of the all-currency financial assets and the off-balance sheet positions.)

All figures in tables are in HUF million except otherwise noted

Consolidated FX financial position of the group in terms of main currencies:

31 December 2016	CHF	EUR	HUF	Total
Assets				
Cash on hand	86	516	3,725	4,327
Balances with the National Bank of Hungary	-	-	60,635	60,635
Due from Banks	830	13,436	56,023	70,289
Securities held for trading	-	2,912	37,822	40,734
Financial assets available-for-sale	-	17,115	49,180	66,295
Shares in associated and joint venture	-	-	4,816	4,816
Derivative financial assets	-	-	933	933
Refinanced mortgage loans	-	-	31,423	31,423
Loans and advances to customers	2,996	28,504	262,973	294,473
Investment property	-	-	780	780
Tangible assets	-	-	4,942	4,942
Goodwill and other intangibles	-	-	2,042	2,042
Deferred tax asset	-	-	3,030	3,030
Other assets	271	188	8,226	8,685
Total assets	**4,183**	**62,671**	**526,550**	**593,404**
Nominal values of derivative assets	2,142	30,485	36,071	68,698
Total assets incl. derivatives	**6,325**	**93,156**	**562,621**	**662,102**

31 December 2016	CHF	EUR	HUF	Total
Liabilities				
Due to banks	1,071	690	45,468	47,229
Deposits	146	56,583	240,343	297,072
Derivative financial liabilities	-	-	1,579	1,579
Issued securities	-	6,617	163,666	170,283
Financial liabilities at fair value through profit or loss, except	-	7,331	4,660	11,991
Leasing liability	-	-	3	3
Current tax liability	-	-	-	-
Deferred tax liability	-	-	-	-
Provisions	-	-	1,546	1,546
Other liabilities	3	473	5,623	6,099
Total liabilities	**1,220**	**71,694**	**462,888**	**535,802**

All figures in tables are in HUF million except otherwise noted

31 December 2016	CHF	EUR	HUF	Total
Shareholders' equity	**-**	**-**	**57,602**	**57,602**
Total liabilities and shareholders' equity	**1,220**	**71,694**	**520,490**	**593,404**
Nominal values of derivative liabilities	5,033	22,316	41,782	69,130
Total liabilities incl. derivatives	**6,253**	**94,010**	**562,272**	**662,534**
Position	(72)	854	(349)	432

Consolidated FX financial position of the group in terms of main currencies (31 December 2015):

31 December 2015	CHF	EUR	HUF	Total
Total assets incl. derivatives	**6,660**	**136,817**	**748,565**	**892,042**
Total liabilities incl. derivatives	**1,540**	**89,775**	**653,505**	**744,820**
Shareholders' equity	**-**	**31,749**	**76,783**	**108,532**
Position	(490)	(943)	1,893	460

46. PREPAYMENT RISK

Prepayment risk means the potential risk that the Bank may suffer losses when clients and refinancing partners partially or entirely repay their outstanding mortgage loans or refinanced loans respectively before the due date in the loan agreement.

The impact of prepayment risk on both assets and liabilities is presented in the statement.

The following method was applied to quantify the effect on net interest income:

An annual prepayment rate (annualized in the course of the year) was determined on the basis of actual amounts prepaid and gross average receivables from outstanding loans. Then interest income was netted of internal settlement interest (i.e. of cost of financing). The resulting net interest income was geared to the amount of outstanding loans for the year and this resulted in the average interest margin on loans for the year. The series of average loans, average prepayment rate and average net interest margin for the period shows the projected effect of prepayments on net interest income. Thus the prepayment risk shows the effect to which extent the interest income decreases because of prepaid (therefore missing) loan capital.

The following method was applied to quantify the effect on shareholders' equity:

The effect on net interest income was adjusted by the actual income from prepaid fees for the period, since those partially compensate the decreasing profit due to the missing net interest income and the decreasing shareholders' equity. The effect on corporate income tax was disregarded.

All figures in tables are in HUF million except otherwise noted

Prepayment risk of the Bank:

	Effect on net interest income	Effect on equity	Effect on net interest income	Effect on equity
	31.12.2016	31.12.2016	31.12.2015	31.12.2015
	HUF million	HUF million	HUF million	HUF million
Loans	**(1,226)**	**(1,001)**	**(1,411)**	**(1,231)**
HUF	(1,182)	(959)	(1,021)	(854)
EUR	(39)	(37)	(61)	(57)
CHF	(5)	(5)	(329)	(320)
Refinanced mortgage loans	**(1,068)**	**(2)**	**(19)**	**103**
HUF	(1,068)	(2)	(314)	(202)
EUR	-	-	1	1
CHF	-	-	294	304
Total	**(2,294)**	**(1,003)**	**(1,430)**	**(1,128)**

47. LIQUIDITY AND MATURITY RISK

Liquidity risk is defined as the risk that the Bank will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Maintaining liquidity is an essential element of banking. The Bank maintains its liquidity by coordinating the maturity of its receivables and payables. At the same time, it applies maturity transformation regulated by limits in order to improve profitability while maintaining solvency at all times.
The Bank regularly reviews prepayments by clients prior to term and takes into consideration their impact in managing market and liquidity risks.

The Bank prepares its liquidity plans and financing position based on different scenarios, also including effects coming from stress tests.

The Bank aims to decrease liquidity risk by diversifying the sources of financing using capital market products (mortgage bonds, bonds) and collecting customer deposits based on both. The Bank also maintains a high level of liquid asset portfolio consisting of mainly government securities. Being a member of the joint and several responsibility system of the Integration strengthens the liquidity position of the members.

Off-balance sheet liabilities are presented at their latest date to be drawn (contractual maturity) in the table below. They would be presented in the first category if their earliest date to be drawn were to be taken.

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Contractual maturities of undiscounted cash flows of financial liabilities as of 31 December 2016

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Banking liabilities							
Due to banks	-	104,514	22,438	24,009	16,317	-	167,278
Deposits	139,342	98,264	47,378	10,304	5	-	295,293
Derivative financial liabilities	-	292	142	1,145	-	-	1,579
Issued securities	-	21,456	31,765	131,185	617	-	185,023
Financial liabilities at fair value through profit or loss, except derivatives	-	4,962	-	1,194	6,518	-	12,674
Off balance sheet commitments	-	26,399	25,329	15,082	5	2	66,817
Total banking liabilities	**139,342**	**255,887**	**127,052**	**182,919**	**23,462**	**2**	**728,664**

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Receivables from derivatives	-	590	12,981	10,810	1,054	267	25,702
Liabilities from derivatives	-	523	13,056	10,742	567	112	25,000
Net value of derivatives	**-**	**67**	**(75)**	**68**	**487**	**155**	**702**

All figures in tables are in HUF million except otherwise noted

Contractual maturities of undiscounted cash flows of financial liabilities as of 31 December 2015

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Banking liabilities							
Due to banks	-	43,107	32,033	14,522	17,891	-	107,553
Deposits	126,425	115,139	65,006	26,719	44	-	333,333
Derivative financial liabilities	-	404	-	1,916	-	-	2,320
Issued securities	-	9,410	65,077	165,844	19,455	-	259,786
Financial liabilities at fair value through profit or loss, except derivatives	-	676	7,526	5,915	6,881	-	20,998
Off balance sheet commitments	-	13,802	39,213	11,728	119	518	65,380
Total banking liabilities	**126,425**	**182,538**	**208,855**	**226,644**	**44,390**	**518**	**789,370**

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Receivables from derivatives	-	25,255	1,534	52,813	948	332	80,882
Liabilities from derivatives	-	25,172	1,637	53,846	744	223	81,622
Net value of derivatives	**-**	**83**	**(103)**	**(1,033)**	**204**	**109**	**(740)**

All figures in tables are in HUF million except otherwise noted

The liability structure is managed by the Bank in the following ways:

- in accordance with the possibilities (demand) of the Hungarian mortgage bond market the Bank is aiming to maximize the maturity of its issued mortgage bonds;
- concentration of the maturity of the mortgage bonds is restricted by limits set in the Bank's internal regulations;
- the Bank is an active player of the mortgage bond markets (repurchasing bonds issued by the Bank).

The table above shows an age analysis of the Bank's liabilities based on the remaining maturity calculated from the balance sheet date. The mortgage bonds and bonds issued by the Bank are presented at actual due principal amounts and increased by the interest payments expected to be paid disclosed in the related information memoranda and programs and are not affected by exchange rate gains and losses or by any valuation difference arising on derivatives. In practice, the maturity of liabilities may depart from the contracted terms.

Maturity analysis of assets and liabilities as of 31 December 2016

	Less than 12 months	Over 12 months
Assets		
Cash on hand	4,327	-
Balances with the National Bank of Hungary	60,635	-
Due from banks	39,940	30,349
Securities held for trading	23,474	17,260
Financial assets available-for-sale	33,594	32,701
Shares in associates and joint ventures	-	4,816
Derivative financial assets	484	449
Refinanced mortgage loans	5,428	25,995
Loans and advances to customers	43,467	251,006
Investment property	-	780
Tangible assets	-	4,942
Goodwill and other intangible assets	-	2,042
Deferred tax assets	-	3,030
Other assets	8,685	-
Total assets	**220,034**	**373,370**

All figures in tables are in HUF million except otherwise noted

	Less than 12 months	Over 12 months
Liabilities		
Due to banks	6,903	40,326
Deposits from customers	286,763	10,309
Derivative financial liabilities	434	1,145
Issued securities	38,481	131,802
Financial liabilities at fair value through profit or loss, except derivatives	4,279	7,712
Finance leases liabilities	-	3
Current tax liabilities	-	-
Deferred taxes liabilities	-	-
Provisions	1,548	-
Other liabilities	6,099	-
Total liabilities	**344,507**	**191,297**

Maturity analysis of assets and liabilities as of 31 December 2015

	Less than 12 months	Over 12 months
Assets		
Cash on hand	3,017	-
Balances with the National Bank of Hungary	162,749	-
Due from banks	45,703	2,505
Securities held for trading	7,405	44,508
Financial assets available-for-sale	25,332	48,710
Shares in associates and joint ventures	-	7,755
Derivative financial assets	699	185
Refinanced mortgage loans	8,629	74,161
Loans and advances to customers	31,453	256,845
Investment property	-	780
Tangible assets	-	6,168
Goodwill and other intangible assets	-	1,915
Deferred tax assets	-	8,232
Other assets	8,069	-
Total assets	**293,056**	**451,764**

All figures in tables are in HUF million except otherwise noted

	Less than 12 months	Over 12 months
Liabilities		
Due to banks	7,361	32,413
Deposits from customers	302,285	26,763
Derivative financial liabilities	392	1,916
Issued securities	49,816	185,299
Financial liabilities at fair value through profit or loss, except derivatives	7,082	12,796
Finance leases liabilities	-	12
Current tax liabilities	1	-
Deferred taxes liabilities	-	1
Provisions	999	-
Other liabilities	9,152	-
Total liabilities	**377,088**	**259,200**

48. MANAGEMENT OF RISK FROM OPERATION

Risk from operation is managed primarily by improving internal rules and regulations, training of staff involved in the various processes, and further enhancement of built-in control mechanisms. The exploration and measurement of the risks is performed by the Group through the collection of the data of the operational risk events and losses, the monitoring of Key Risk Indicators and the implementation of risk self-assessment. The Bank's management considers feedback to be particularly important in terms of operations-related risk management, as this is the tool to check the effectiveness of measures taken to eliminate risks.

49. TREATMENT OF RISK CONCENTRATION

The Bank is significantly exposed to the status of real estate market regarding the high proportion of real estate in securities. This concentration risk is mitigated by applying conservative method in collateral values and cover rate and also by diversifying its product portfolio from collateral perspective (meaning to increase the proportion of other than real estate securities). Taking risk in corporate segment can do in compliance with the sectoral limits.

All figures in tables are in HUF million except otherwise noted

50. CALCULATION OF REGULATORY CAPITAL, CAPITAL ADEQUACY AND ROAE

The calculation of regulatory capital based on the proposed banking and capital adequacy directive of the European Union and the guidelines of the Committee of European Banking Supervisors (Guidelines on prudential filters for regulatory capital) cash flow security reserve should be ignored, thus ensuring the soundness of the comparison with previous periods.

The Hungarian Financial Supervisory Authority has given permission to the Group to apply – at gradual implementation – (a) the IRB (internal qualifying) method for credit risk from 1 July 2008 and (b) the AMA for operational risk from 31 December 2011 regarding the calculation of solvency margin.

The National Bank of Hungary has conducted the supervisory review process (SREP) at the end of 2015, from which the Bank received the decision on 19 April 2016. The Bank Group has to apply the SREP capital requirement from 30 June 2016.

According to the resolution no. H-EN-I-36./2017 (on 1 January 2017) the National Bank of Hungary – with the acceptance of application provided by SZHISZ, Magyar Takarékbank Ltd., and FHB Mortgage Bank - authorized FHB to apply individual exemption and terminated the obligation for compliance with sub-consolidated level requirements.

The Group's Tier 1 capital adequacy ratio was 13.71 % as of 31 December 2016 and 20.13% as of 31 December 2015. The Group applies the Hungarian accounting standards regarding consolidated risk-weighted assets and IFRS standards regarding Tier 1 items.

According to this the Group's regulatory capital includes the following elements: share capital – repurchased treasury shares + share premium + general reserve + share option reserve + retained earnings – intangible assets – IRB loss.

The Group's capital adequacy ratio = regulatory capital / (total capital requirement / 8%).

	31 December 2016	31 December 2015
OWN FUNDS	**45,612**	**66,461**
TIER 1 CAPITAL	**42,606**	**66,461**
COMMON EQUITY TIER 1 CAPITAL	**40,359**	**41,395**
Capital instruments eligible as CET1 Capital	38,567	8,102
Retained earnings	1,539	16,135
Accumulated other comprehensive income	587	561
Other reserves	-	-
Minority interest given recognition in CET1 capital	9,761	9,760
Transitional adjustments due to additional minority interests	-	6,960
Adjustments to CET1 due to prudential filters	(460)	(308)
(-) Goodwill	166	166
(-) Other intangible assets	958	981
Other transitional adjustments to CET1 Capital	-	12,187
ADDITIONAL TIER 1 CAPITAL	**2,247**	**25,066**
Capital instruments eligible as AT1 Capital	-	31,749
Other AT1 Capital elements and transitional adjustment	-	(6,683)
TIER 2 CAPITAL	**3,006**	**-**
CET1 Capital ratio	**12.14%**	**12.54%**
T1 Capital ratio	**13.71%**	**20.13%**

	31 December 2016	31 December 2015
Capital requirement (min)	26,606	26,414
Total exposures amount	332,577	330,172
ROAE (return on average equity %)	**(18.7)**	**(10.7)**

All figures in tables are in HUF million except otherwise noted

51. RELATED PARTY TRANSACTIONS

For the purpose of the financial statements, Group identified related parties based on definition of IAS 24 including all the enterprises that directly or indirectly through one or more intermediaries are controlled by the reporting enterprise (this includes parents and subsidiaries) and key management personnel, including the member of the Board and Supervisory Board. For the purposes of this Report, related parties also include shareholders whose holding in the Bank exceeds 10% (A64 Trustee Ltd. - until 14.10.2016.-, VCP Finanz Holding Ltd. – until 09.12.2016 -, from 14.10.2016. Fókusz Takarékszövetkezet and B3 Takarékszövetkezet, from 09.12.2016. Magyar Takarékszövetkezeti Bank Ltd., and from 2010 also Allianz Hungary Insurance Ltd). Related parties have the power of control over or have a significant influence in, decisions relating to the finances and operation of another enterprise. The Group enters into transactions with related parties under market conditions. For the list of the subsidiaries, associates and joint ventures please refer to Note 2.4.

	31 December 2016	31 December 2015
Loans to executives, members of the Board of Directors and Supervisory Board	-	-
Gross remuneration		
Salary	81	89
Bonus	15	15
Honorarium	28	31
Total remuneration	**124**	**135**

The key management personnel had HUF 2.5 million FHB shares in 2016. In 2015 they had HUF 179 million FHB shares and HUF 101 million issued securities.
Balances and transactions between the Group and its subsidiaries, which are related parties of the Group, have been eliminated on consolidation and are not disclosed in this note. Details of transaction in 2016 and 2015 between the Group and other related parties are disclosed below:

All figures in tables are in HUF million except otherwise noted

Notes to the Consolidated Financial Statements

Details of transactions as of 31 December 2016

	Parent	Associates and joint ventures	Key management
Due from banks	30,350	70	-
Loans and advances to customers	-	8,255	28
Other assets	20	1,321	-
Total assets	**30,370**	**9,646**	**28**
Due to banks	4,000	-	-
Deposits from customers	-	2,840	14
Other liabilities	-	3,038	-
Total liabilities	**4,000**	**5,878**	**14**
Interest income	327	336	2
Interest expense	-	(14)	(1)
Net interest income	**327**	**322**	**1**
Fee and commission income	154	274	1
Fee and commission expense	(1)	-	-
Net fee and commission income	**153**	**274**	**1**
Other operating income	28	526	-
Other operating expense	-	(62)	-
Operating income	**508**	**1,060**	**2**
Operating expense	(50)	(572)	(124)
Profit/loss on transactions with related parties	**458**	**488**	**(122)**

Details of transactions as of 31 December 2015

	Parent	Associates and joint ventures	Key management
Loans and advances to customers	-	8,363	-
Other assets	-	1,131	-
Total assets	**-**	**9,494**	**-**
Deposits from customers	-	1,703	4,275
Other liabilities	-	187	-
Total liabilities	**-**	**1,890**	**4,275**
Interest income	-	1,061	-
Interest expense	-	(34)	(359)
Net interest income	**-**	**1,027**	**(359)**
Fee and commission income	-	-	1
Fee and commission expense	-	-	-
Net fee and commission income	**-**	**-**	**1**
Other operating income	-	324	-
Other operating expense	-	-	-
Operating income	**-**	**1,351**	**(358)**
Operating expense	(65)	(490)	(135)
Profit/loss on transactions with related parties	**(65)**	**861**	**(493)**

All figures in tables are in HUF million except otherwise noted

52. NET GAINS

The allocation of operating income to financial instrument categories excluding gains from foreign exchange transactions:

2016	Financial assets at fair value through profit or loss	Financial assets available-for-sale	Loans and advances	Financial liabilities at fair value through profit or loss	Financial liabilities at amortised cost	Not linked to financial instruments	Total
Interest income	1,973	1,260	25,509	-	-	-	28,742
Interest expense	-	-	-	(1,425)	(15,061)	-	(16,486)
Net interest income	**1,973**	**1,260**	**25,509**	**(1,425)**	**(15,061)**	**-**	**12,256**
Fee and commission income	-	-	4,041	-	5,171	964	10,176
Fee and commission expense	-	-	(1,144)	-	(848)	(220)	(2,212)
Net fee and commission income	**-**	**-**	**2,897**	**-**	**4,323**	**744**	**7,964**
Change in fair value of derivatives	(301)	-	-	1,266	-	-	965
Gains from securities	422	347	-	149	2,116	-	3,034
Other operating income	-	-	-	-	-	2,216	2,216
Other operating expense	-	-	-	-	-	(9,205)	(9,205)
Operating income	**2,094**	**1,607**	**28,406**	**(10)**	**(8,622)**	**(6,245)**	**17,230**

All figures in tables are in HUF million except otherwise noted

Notes to the Consolidated Financial Statements

2015	Financial assets at fair value through profit or loss	Financial assets available-for-sale	Loans and advances	Financial liabilities at fair value through profit or loss	Financial liabilities at amortised cost	Not linked to financial instruments	Total
Interest income	6,291	1,334	33,534	-	-	-	41,159
Interest expense	-	-	-	(5,076)	(21,455)	-	(26,531)
Net interest income	**6,291**	**1,334**	**33,534**	**(5,076)**	**(21,455)**	**-**	**14,628**
Fee and commission income	-	-	2,841	-	4,616	895	8,352
Fee and commission expense	-	-	(915)	-	(214)	(205)	(1,334)
Net fee and commission income	**-**	**-**	**1,926**	**-**	**4,402**	**690**	**7,018**
Change in fair value of derivatives	(419)	-	-	(1,761)	-	-	(2,180)
Gains from securities	333	837	-	118	1,392	848	3,528
Other operating income	-	-	-	-	-	1,397	1,397
Other operating expense	-	-	(87)	-	-	(11,304)	(11,391)
Operating income	**6,205**	**2,171**	**35,373**	**(6,719)**	**(15,661)**	**(8,369)**	**13,000**

All figures in tables are in HUF million except otherwise noted

53. SEGMENT REPORTING BY BUSINESS SEGMENTS

The Group distinguishes business segments according to the organizational structure of the company. The profitability of the company is presented based on this structure. The segments have separable and assignable income, expense, assets and liabilities.
The reportable segments of the Group on the base of IFRS 8 are the following:

- Retail: the Bank provides a wide range of services to its retail customers (retail bank accounts, deposits, savings, loans) through the branch network and with the collaboration of the Hungarian Post.
- Corporate: the Bank is trying to satisfy not only the retail but the corporate customers' financial needs providing corporate accounts, deposits, loans in different type, size with different collaterals, guarantees.
- Investment services: the Bank also provides investment services to retail and corporate clients.
- Treasury: the segment's responsiblities include liquidity management, asset and liability management, and security issue on behalf of the FHB Mortgage Bank.
- Refinancing: refinancing mortgage loans to FHB Commercial Bank and other partner institutions Leasing: in the Bank Group FHB Lízing Ltd. provides leasing, the business activity of this company is presented in this category.
- Other: the Bank's core business is supported by other subsidiaries, which profitability's are reported in this category. These companies are the following:
    - Diófa Alapkezelő Ltd.
    - Magyar Kártyaszolgáltató Ltd.
    - FHB Real Estate Ltd.
    - FHB Invest Kft.
    - Káry-Villa Kft.

Segment report, 31 December 2016	Retail	Corporate	Investment services	Treasury	Refinancing	Leasing	Other	Total
Net interest income	12,073	2,057	308	(4,623)	2,689	205	(453)	12,256
Other net income	(216)	744	408	3,570	(447)	3,016	(914)	6,161
Provision for impairment on loan losses	(7,546)	(344)	-	-	27	(294)	(35)	(8,192)
Direct expense	(12,728)	(1,650)	(566)	(537)	(525)	(680)	(2,859)	(19,545)
Operating result	(8,417)	807	150	(1,590)	1,744	2,247	(4,261)	(9,320)
Profit before tax	-	-		-	-		-	(9,320)
Segment assets	188,082	98,717	9,753	226,221	31,423	13,578	25,630	593,404
Segment liabilities and equity	125,397	118,366	53,597	276,423	-	13,578	6,043	593,404

All figures in tables are in HUF million except otherwise noted

Segment report, 31 December 2015	Retail	Corporate	Treasury	Refinan-cing	Other*	Total
Net interest income	11,446	1,932	(493)	2,241	(498)	14,628
Other net income	1,101	1,306	(4,330)	(159)	(631)	(2,713)
Provision for impairment on loan losses	(3,879)	(1,177)	-	-	4,194	(862)
Direct expense	(12,279)	(1,835)	(1,601)	(457)	(2,592)	(18,764)
Operating result	(3,611)	226	(6,424)	1,625	473	(7,711)
Profit before tax	-	-	-	-	-	(7,711)
Segment assets	198,774	87,708	334,919	82,790	40,629	744,820
Segment liabilities and equity	128,941	131,260	442,707	-	41,912	744,820

*Including the real estate services and real estate leasing.

54. SIGNIFICANT EVENTS AFTER BALANCE SHEET DATE

As a result of negotiations commenced in 2016 the Bank has already contracted with 4 new external refinancing partners and the first remittances occurred with a worth of more than 10 billion HUF.

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